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SECOND OVERSIGHT HEARING ON THE RESOLUTION TRUST CORPORATION

HEARING

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FIRST CONGRESS

SECOND SESSION

ON

THE ACTIVITIES OF THE RESOLUTION TRUST CORPORATION [RTC]

JANUARY 31, 1990

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OVERSIGHT HEARING ON THE RESOLUTION TRUST CORPORATION

WEDNESDAY, JANUARY 31, 1990

U.S. SENATE,
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS,
Washington, DC.

The committee met at 10:05 a.m., in room SD–538 of the Dirksen Senate Office Building, Senator Donald W. Riegle, Jr. (chairman of the committee) presiding.

Present: Senators Riegle, Cranston, Sarbanes, Dixon, Shelby, Graham, Bryan, Garn, Heinz, D'Amato, Gramm, Mack, Roth, and Pressler.

OPENING STATEMENT OF CHAIRMAN RIEGLE

The CHAIRMAN. The committee will come to order.

Let me say, we have got a full room today, because this is a very important subject, and we have important witnesses who are testifying. And so we will do our best to accommodate as many people in the room in the course of the morning as we can.

I want to ask that everyone try to be as quiet as possible, so that the witnesses can be heard throughout the room.

I want to welcome the members of the Oversight Board and the Chairman of the Resolution Trust Corporation to the committee's second oversight hearing on the RTC. Although the RTC came into being only 6 months ago, the American public must have confidence that the resolution process is being effectively implemented with a highly skilled team that is working together smoothly.

The committee fully understands the difficulty and complexity of that task, so our active oversight will be constructive in tone, and not a matter of constant criticism.

The RTC's track record, though short, is already praiseworthy in some respects. In particular, I want to commend the RTC for working toward a fair and open asset disposition process, for publishing and selling over 100,000 copies of this detailed inventory of over 30,000 properties with a book value of over $15 billion, and moving to computerize the inventory for easy updating and public access. This is an enormous job, and to get it moving in an orderly fashion is obviously a most difficult assignment.

Having said that, there is concern, however, about the RTC's development. I think the Oversight Board has allowed confusion over the so-called "working capital issue" to spread unnecessarily. Six months after enactment, no working capital mechanism has yet been chosen. A delay in announcing the mechanism has led to stories suggesting that Congress needs to pass additional legislation before the RTC can get on with its job, and that is just not true.

The law we passed provides several alternatives for raising working capital, as I think you know. And I am pleased that the administration is considering using the Federal Financing Bank, because it is the cheapest source of working capital; but that issue needs to be resolved soon.

In another area, on February 22 of last year, Secretary Brady testified here and outlined the administration's plan to deal with the thrift crisis. Secretary Brady estimated that the RTC would have to resolve 500 thrifts with estimated assets of $265 billion.

Because of delays which would increase costs to taxpayers, the administration promised to have the RTC "hit the ground running"—that was the quote upon enactment. I would say, in terms of judging where we are today, that the problem appears bigger than anticipated, and action has been slower than contemplated.

As of January 8 of this year, the RTC had 285 failed thrifts, with $105 billion in assets under its jurisdiction. Current official estimates are that the RTC's ultimate case load will increase by at least another 295 thrifts, with an estimated $200 billion more in assets, and perhaps by as much as 620 additional thrifts, with $400 billion in additional assets.

Now, this means that the RTC's total case load could be over 900 thrifts, with more than $500 billion in assets. And yet today, the RTC has sold only 40 failed thrifts, and 36 of those 40 were small institutions. And as Mr. Seidman points out, we will not know the final cost of selling even those 40 until the RTC sells over $5 billion bad assets that it acquired from them.

America has few domestic policy problems as difficult to handle and resolve as the thrift crisis. But 6 months after FIRREA became law, many key public offices remain vacant, including, I might say, two at the table today that otherwise should be, and in due course one assumes will be, occupied by other members of the Oversight Board.

Listing the vacancies that we now have—and they are all important ones—I would start with the two positions on the Oversight Board itself, the outside positions. The RTC's Board of Directors has one vacancy, and another vacancy will arise when Director Wall departs. And numerous other key positions also remain unfilled, including three regular members of the Federal Housing Finance Board, one consumer representative on the Federal Housing Finance Board, and of course the inspector general of the RTC.

It is hard to see how the thrift crisis can be successfully resolved while so many of the key jobs remain vacant. I will say to you that this committee will help in every way it can in expediting the handling of nominees before this committee for confirmation, once they are named. But until they are named and sent to us, there is very little we can do in that regard, other than to urge you to move quickly on the matter.

The RTC's strategic plan represents a significant effort during a short period, and that may help explain why it lacks, I think, the specific detail that we had hoped to see. And that is why the committee particularly looks forward today to a more detailed explanation of the plan from our witnesses.

Having said that, and before yielding to Senator Garn, let me also say that these are very difficult matters to deal with, and I appreciate, and I know my collegues do, the complexity of that. And we appreciate the commitment of effort by each of the three of you and others that will speak later in the morning, as to the roles that each of you have been called upon and assigned to play in this effort.

So we want to work with you. We want to continue to maintain the kind of constructive, bipartisan working relationship that we had all last year in developing legislation both on the thrift crisis and as well on housing matters that we have thus far dealt with, with more to be done of course this year.

So with that, let me yield to Senator Garn.

OPENING STATEMENT OF SENATOR GARN

Senator GARN. Thank you, Mr. Chairman.

About 5½ months have passed since we created the Resolution Trust Corporation to handle the disposition of insolvent thrift institutions. Given the very large sums of taxpayer funds that will be expended in this process, certainly close congressional oversight is warranted. This morning's hearing is an important part of that responsibility.

The respective roles of our witnesses need to be reemphasized, for some public confusion appears to have developed on this issue. FDIC Chairman Bill Seidman is here in his capacity as Chairman of the RTC. Treasury Deputy Secretary John Robson, Federal Reserve Board Chairman Alan Greenspan, and HUD Secretary Jack Kemp, are here in their capacity as members of the Oversight Board of the RTC. I also note the presence of Dan Kearney, who is at present the CEO of the Oversight Board.

The Oversight Board and the RTC, as established in last year's legislation, have very different responsibilities. The most immediate responsibility of the RTC is to handle the disposition of individual, insolvent thrift institutions. The Oversight Board was created, in view of the very large sums of public moneys to be expended by the RTC, to provide administration and public control of the overall policies followed by the RTC, and over the spending of those public funds.

In this regard, I want to restate my support for public input into the Oversight Board, and I urge the administration to move quickly in nominating the two public members of that Board.

The final issue I want to address in my opening statement is the pace of case resolutions. I am certainly convinced that all delay does is add to the cost of solving this problem. As an example, I would point out that most of the real estate assets in insolvent thrifts are not buildings and raw land, as many people think; but rather, loans secured by real estate. The quicker the RTC can move to restructure those loans, the more likely the real estate projects can be made viable, and the smaller the losses will be.

The need to proceed with case resolutions as quickly and as prudently as possible also must be remembered in the debate over working capital. Hopefully, this hearing will finally put to rest any lingering confusion over the difference between RTC's need for working capital and the need for funds to cover the losses in the thrift industry.

Even more important is the need to avoid any delay in case resolution that could be caused by confusion or disagreement over how working capital should be raised.

One more thing needs to be said regarding the pace of case resolution. Developing last year's legislation, Congress worked hard at trying to ensure that the crisis in the thrift industry would not be repeated. If some of the provisions we adopted to protect future taxpayers are having the unintended effect of complicating or slowing down your task of disposing of today's insolvent thrifts, I would urge you to be very frank and very honest with us, and tell us what those provisions are.

You have got your problems in getting started and gearing up a new agency with a very large task. That does not mean that everything we passed last summer was perfect, when you start to work with it and see how it operates. So I would suggest that you be very candid with us. If there are changes that we can make to speed up this process, we would like to do it.

I would also like to emphasize, as I have been doing for some years, the need for speed, recognizing your problems and difficulties of getting going. The cost has grown enormously. And if you will bear with me, I would like to just quote something from the Congressional Record:

> Part of this bill will infuse $3 billion into FSLIC over the next year. With funds coming entirely from the thrift industry, using no tax dollars and no Federal guarantees. It also establishes the mechanisms to raise a total of $25 billion over 5 years. Mr. President, FSLIC recapitalization is urgently needed. FSLIC primary reserves have dropped to $2.5 billion, and the ratio of these reserves to insured deposits has deteriorated steadily in recent years. At the same time, FSLIC's case load includes 125 severely troubled thrifts, with $42 billion in assets and will include another 96 troubled thrifts with $35 billion of assets in the next 12 months. The cost of resolving the current case load without the expected additions is $7 to $10 billion. This is three to four times the primary reserves now available to the insurance fund. The result is that FSLIC must now keep insolvent thrifts open, because it does not have the funds to close them. This risks even much larger losses to the fund in the future, and unfairly permits insolvent institutions to compete for deposits with healthy thrifts and banks. If interest rates rise, the cost will be far, far greater. Furthermore, these estimates do not take into account credit risks, deteriorating asset quality, or deposit losses of competing institutions, all of which could make the overall losses even worse. There is no question in anyone's mind, including all the financial regulators, that FSLIC recap is necessary. The real question is whether it is necessary this month, next month, or in 6 months. And the answer is that we should not tempt the hand of fate by doing nothing now. The consequences of that kind of inaction are bleak, potentially devastating losses to FSLIC, the possibility of a merger of FSLIC and FDIC, and the possibility of direct Federal appropriations.

Ladies and gentlemen, that was a statement I made on the Senate floor on October 18, 1986, so I am now a newfound convert to speed.

That was the night the Senate passed $15 billion in FSLIC recap. And when Chairman Riegle—at 1 o'clock in the morning—when all of our colleagues in the cloakroom said, "It is time to do something about this. Let's support the chairman," this chairman, at that time. And we passed that bill.

That is rather significant. It is now 3 years and 3 months since this committee and many members of this committee said, "This is a crisis, and it is going to get worse." Three years and 3 months later, we still have not done anything about it.

I would suggest, gentlemen, with all your difficulties, that you move as rapidly as possible, or somebody else is going to be giving a speech about 3 years from now, when it is a $400 or $500 billion problem.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Garn.

Senator Cranston.

OPENING STATEMENT OF SENATOR CRANSTON

Senator CRANSTON. I will be very brief. I know you have a monumental task, and we have much ground to cover today.

Considering the fact that the RTC is managing 200 thrifts, and managing some $100 billion in distressed assets, you plainly have a monumental task before you.

Our mission now is to monitor the progress of the RTC. It has been over 5 months since we created it. And frankly, even though 5 months is a short period of time, I am concerned about the pace of progress so far.

I do recognize that with any organization, especially one as big and with as many complicated problems as you face, there are bound to be start-up problems. The question that I hope will be answered today is whether the start-up problems are behind us, and whether we can expect to see a faster pace now in case resolutions.

Additionally, I have concerns about the working capital issue that Senator Garn and Senator Riegle have alluded to. Supposedly, that was resolved; plainly, it is not. It has reared its ugly head again. As the RTC indicates, more money will be needed, while not exhausting what has already been made available.

I would like to see this issue finally put to rest. I know we all hope that will be the case. If more money is needed than the administration requested, then the American people need to know how much, and why.

An important concern relates to the implementation of the eligible housing programs. The local housing authorities have indicated that they disagree with the RTC's preliminary approach for making homes available to low- and moderate-income buyers, and that they would like to play a greater role in assisting in the determination of the most cost-effective method of moving the properties of the RTC.

Swifter movement from the administration on the two public interest members on the Oversight Board might go a long way in helping to resolve some of these problems.

As the author, along with Congressman Mfume, of the Minority and Women Business Owners Outreach Program, and the Equal Employment Provision, I am interested in what the RTC is doing to ensure inclusion to the maximum extent possible of minorities and women in the contracting and sale of asset opportunities. The strategic plan appears to me to be deficient in that regard.

I have a number of other concerns, but I will not take the time to express them at this point.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Cranston.

Senator Heinz.

OPENING STATEMENT OF SENATOR HEINZ

Senator HEINZ. Mr. Chairman, I want to join in welcoming the three existing members of the Oversight Board of the Resolution Trust Corporation. They are of course accountable for all the operations of the Resolution Trust Corporation. I'll bet you fellows, when you got into your current jobs, never knew we were going to do that to you; but here you are.

Just by way of background, I want to observe that 6 months ago Congress passed the Financial Reform, Recovery, and Enforcement Act, commonly known as the "FIRRE" Act, and I think that is a fitting acronym, since this law burned a multibillion dollar hole in the taxpayers' pocket.

The law provided $50 billion to snuff out the burning insolvencies in the thrift industry. It was a 5 alarm fire. Indeed, it is fair to say we mobilized the biggest and most expensive fire brigade in our nation's history.

However, there are now suggestions that the check that we wrote just a few months ago may be no more than a large drop in the savings and loan bailout bucket. The fire is still burning. Indeed, after some 5 years of our regulators being at the scene of the fire, we are hearing that the fire is not only still burning, but it is a lot bigger than the fire department reported just 12 months ago. We are now being told that it may be not a 5 alarm fire, we are being told it really is a 10 alarm fire.

It has been reported as well that, because there are two agencies responsible for resolving this crisis—the Resolution Trust Corporation, and the Oversight Board—that there is some confusion about where the buck stops. Frankly, I think more time should be spent worrying about where the bucks should go, than where they should stop.

These are, as we all know, the taxpayers' dollars. They should be spent as wisely and as quickly as possible. Congress was told that speed was essential if we are to resolve the savings and loan problems expeditiously and economically.

The bids received so far have caused some observers to remark that a thrift's only asset these days are its deposit liabilities, and that its assets are the RTC's biggest liability. If no one followed that, it will be in the Record tomorrow.

Investors with capital want to buy a business that will earn money, not burn money. We should, I think, explore ways to attract investors to the thrift industry who are currently, I fear, being scared away.

Mr. Chairman, we want to hear from our witnesses, so I will just say in conclusion that the RTC and the Oversight Board confront a huge problem of unprecedented proportions. We are all sympathetic to the difficulties that they are grappling with. None of the three gentlemen here today came to service in Government as experts on the FSLIC, the thrift industry—not that they were in any way ignorant about them; but they never worked as regulators in that industry before their present jobs. It is important, therefore that the Congress closely monitor this process.

While there may be differences of opinion on the best approach, I think we can all agree that the surest way to solve a multibillion dollar problem is to get quickly off the dime.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Heinz.

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

OPENNING STATEMENT OF SENATOR GRAHAM

I wish to commend you for starting the committee's 1990 agenda with the oversight hearings on the RTC. Congressional oversight should be one of the top priorities of this committee, as we continue to focus on the S&L crisis.

The total cost of the bailout continues to be, as it was in 1989, one of my major concerns. Will the cost be more than we anticipated, and more than last year's bill provided? Do the regulators think they have enough resources to handle this job expeditiously?

If not, I urge them to tell us today that they do not have the resources. We want all the numbers available. I believe that history will clearly record that the cost of this program will be substantially more than it was necessary that it be, because of failure of regulators in the mid-1980's to tell the Congress and the American people the extent of the problem and therefore create the environment for effective action.

Another question is the impact of interest rate costs. Will changes increase or decrease last year's estimated cost for solving the S&L problem? In 1989, the administration projected that the Resolution Trust Corporation's borrowing cost would begin at 8.25 percent, and decline to 7.25 percent. Instead, at the close of the January 23 market, Treasury's offerings of $5 billion in 40-year RTC bonds were yielding 8.66 percent.

Another cost impact is the way we financed last year's bill, by putting part of the bill on-budget, and part off-budget. We knew that we were increasing the cost of the ultimate resolution by putting part of this in off-budget RTC financing. What the Washington Post of January 25 told us was that the cost was much greater than had been anticipated in 1989.

If this is so, should we reconsider last year's decision to move only part of the cost of this bailout on-budget? What will be the total cost of the bailout? How will additional funds be secured, if we need them? Do we have sufficient authority to handle the scale of the problem, to finance any shortfall caused by management difficulties or delays in getting rid of property? I look to the panels today for answers to those questions.

Another question has arisen about asset disposition which I believe is particularly appropriate to the first panel; and that is, are the agencies—HUD, VA, and the RTC—undermining each other when they dispose of the various properties they hold? My questions later in the hearing will focus on the panel's knowledge about the management and coordination of the disposition of property, particularly the issue of asset recovery.

Mr. Chairman, I have some other questions relative to RTC personnel policy. There have been some questions about persons who had been found to be incompetent in their previous positions, serving at individual S&L's, who are now recycling back into the industry through the RTC. Mr. Chairman, this is a major test of this Congress, in terms of its ability to provide effective oversight, to demand accurate information, and then to act on that information.

We have increased the cost by delay in the past, let us not be subject to that criticism in the future.

The CHAIRMAN. Let me just say, before calling on Senator D'Amato, that I think the turn-out of Senators here this morning, and the feeling that you are hearing expressed by each as they speak, gives you a sense as to how important this issue is seen to be by the committee and by the Senate as a whole.

So we will proceed on down through in our normal fashion, to allow each member to make whatever opening comments they feel are appropriate.

[The prepared statement of Senator Graham follows:]

PREPARED STATEMENT OF SENATOR GRAHAM

Mr. Chairman, I commend you for starting the committee's 1990 agenda with an oversight hearing on the Resolution Trust Corporation (RTC).

Congressional oversight should be one of the top priorities for this committee as we continue to focus on the savings and loan problem.

The total cost for the bailout continues to be one of my major concerns. Will the cost be more than we anticipated and more than last year's bill provided? Do the regulators think they have enough resources to handle this job?

If not, I want them to tell us today that they don't have enough resources. We want all the numbers on the table.

Another question is the impact of interest rate costs. Will changes increase or decrease last year's estimated cost for solving the savings and loan problem? In 1989, the administration projected the resolution financing corporation's borrowing costs would begin at 8.25 percent and eventually decline to 7.25 percent. Instead, at the close of January 23, Treasury's offering of $5 billion in 40-year RTC bonds were yielding 8.66 percent.

Another cost impact question is the way we financed last year's bill by putting part of the bill on-budget and part off-budget. The Washington Post of January 25 reports the cost will be much greater than anticipated. If this is so, should we reconsider last year's decision to move only part of the cost on budget?

What will be the total cost of the bailout? How will additional funds be secured if we need them? Do we have sufficient authority to handle the scale of the problem to finance any shortfall caused by management difficulties or delays in getting rid of property? I look to our panel today for answers.

Other questions have arisen about asset disposition. Are the agencies—HUD, VA, and the RTC—undermining each other when they dispose of the various properties they hold? My questions later in the hearing will focus on the panel's knowledge about the managing and coordinating of the disposition of property, particularly the issue of asset recovery.

Finally, other concerns about the RTC personnel have come up, that is questions about the RTC hiring staff who were removed from various savings and loans for incompetence, and bringing back these people to manage assets in assisted institutions. Concerns that some individuals have been brought in to manage assets, who have never managed assets before or in some cases there has been a mismatch of skills, such as a stockbroker managing real estate.

Mr. Chairman, we should be concerned about the overall cost of the savings and loan resolution. We must make sure that everyone involved is properly evaluating the costs of their decisionmaking and telling Congress the true story. The Congress and the regulators must know what our true financial status is and we must be sure the regulators have the programs and the appropriate people to do the job.

Senator D'Amato.

OPENING STATEMENT OF SENATOR D'AMATO

Senator D'Amato. Mr. Chairman, I am going to ask that the full text of my remarks be submitted in the record as if read in its entirety. And with your permission, I will just make two observations.

I think Senator Heinz understated the problem—and I certainly agree with him—as it relates to our failure in last year's legislation to take into consideration that if we are looking for the capital that we said we were in the private sector to be invested in this area, then we had better provide them with the opportunity to purchase something of value, and that makes sense.

And there were those of us who—until we were hoarse—we were threatened with all kinds of terrible things; that we were not mindful of the taxpayers, and had to drop our opposition to what we saw as legislation that did not provide the opportunity for the private sector to come in and invest money.

As a matter of fact, I think it is important that we look at what we did last year, in light of, how can we help RTC? Their hands are tied. What flexibility do they have? What about the oversight people?

When you have an institution—and I bring it forth not because of parochial interest, but a bank, a thrift in Long Island, the Long Island Savings Bank, was making money—I do not know what it earns, $150, $200 million. It was induced to take over a failing thrift. It took it over. It was pledged this business called "goodwill," $400 or $500 million. That institution is making money.

But yet, under the scenario that we were almost bludgeoned into agreeing to—there is capital that had to be there—notwithstanding that they are earning money, they may, if things proceed as they have in the past, ultimately fall, with no fault of the RTC Board, into their hands—Senator Dixon was one of those who raised these concerns—into their hands. Notwithstanding that here is a bank that is earning money.

And the taxpayers are going to have to come in and pay maybe billions of dollars. You are not going to get better management. It is not a question that the management is not doing a good job.

I think it behooves us to have some courage at some point in time to say: "My God, you know, we are not interested in bailing out the banker, or preserving a bad banker in operation; we are interested in what makes good, common sense, and in protecting the taxpayers, and also in having the courage to say in certain instances that goodwill should have the ability to be carried on where bankers demonstrate this." In this case, they tell me this bank probably could not, notwithstanding that it is earning hundreds of millions of dollars. It certainly is no threat to the taxpayer. It will wind up costing the taxpayer money if it falls under the aegis of RTC. It would take them 17 or 18 years to hit the capital requirement which is now set. It wiped out goodwill. Right now, they have a capital thing of about over 9 percent.

We had better take a look at this legislation, if we are going to help these fellows do the job for the American taxpayers, to see to it that it has the kind of flexibility that is necessary to protect the taxpayer and to attract capital where necessary. Nobody is going to put money into these institutions if you do not give them the ability to do that which they should.

So I think that we should take a look at that. Otherwise, we are going to be back here, and there is nothing they are going to do. We are just going to have that cookie monster putting more and more money in here for many, many years into the future.

Thank you, Mr. Chairman.

[The prepared statement of Senator D'Amato follows:]

PREPARED STATEMENT OF SENATOR D'AMATO

Mr. Chairman, as we deliberated over the FIRREA legislation last year, some of my colleagues and I grew hoarse calling for a thrift bill that attracted capital to the thrift industry so the RTC could clean up the mess at the least cost to the taxpayer. Unfortunately, unless great surprises are in store, FIRREA is not such a bill.

The market is saying that thrifts are not good investments. There seems to be little interest among investors in acquiring thrifts. I hope I am wrong, but based on what I see, the RTC has seen a great deal more interest in branches, deposits, and fire-sale real estate than in whole-thrift acquisitions.

One of the crucial assumptions underlying FIRREA was that the thrift industry would grow and provide increasing funds to the RTC through deposit insurance premiums. Deposits in thrifts shrank throughout 1989, continuing to shrink in the months following passage of FIRREA. As they shrink so does the industry's contribution to resolution. If the industry does not pay, the taxpayer will.

I have always discouraged debate over the "size of the hole" and I do not intend to promote it now. But I believe that cost is growing and I fear that the FIRREA legislation and over-zealous regulatory interpretation of its provision are increasing the taxpayers' share of thrift resolution. Mr. Chairman, and distinguished witnesses, I hope that we can avoid turning the RTC into another one of Mr. Darman's ultimate cookie monsters or budget pacmen. If we fail, the RTC will gobble up millions and billions of taxpayer dollars for years long into the future.

The CHAIRMAN. Senator Bryan.

Senator BRYAN. Mr. Chairman, I commend you for convening this hearing, and inviting this panel to testify today. I am going to reserve my time for questions. I am anxious to hear what the panel has to say.

The CHAIRMAN. Very good.

Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

Since "speed" is the word that has been used most often, I think I will just allow us to go on to the next individual to make an opening statement.

The CHAIRMAN. Thank you, Senator Mack.

Senator Shelby.

Senator SHELBY. Mr. Chairman, I have a written statement I would like to include in the record in its entirety, and I have a couple of observations to make.

The CHAIRMAN. Please proceed.

OPENING STATEMENT OF SENATOR SHELBY

Senator SHELBY. Mr. Chairman, you used—well, you have not, but I believe Senator Heinz used the term that a big fire is going here, a fire is burning. I believe it is more like hemorrhaging, that the American taxpayer is hemorrhaging here.

I would like to know, when are we going to get to some real numbers on what this is going to cost, if you on the panel can put those numbers together. You have not been able to do it in the past.

You know, we were told last year that $50 billion was going to do it. Now, we hear figures from different people of up to $200 billion to $300 billion. We would like some real figures. Because everywhere I go in my State of Alabama, people want to know who is going to pay for it—they know who is going to pay for it, the American taxpayer, ultimately. But they would like a real bottom line on this, if you can come up with one.

I think it would help this committee. Senator Garn talked about candor, and I think if we are honest and if we get to the real numbers on this, if they can be gotten to, we are all going to be better off, and we will not have to come to these hearings over and over for the same reason, to hear the same thing, that is that it is going to cost more but nobody knows what.

Thank you, Mr. Chairman.

The **CHAIRMAN**. Thank you, Senator Shelby. We will make that statement part of the record.

[The prepared statement of Senator Shelby follows:]

PREPARED STATEMENT OF SENATOR SHELBY

Mr. Chairman, I commend you for scheduling this hearing at this time so that we might all have a chance to discuss the Resolution Trust Corporation's progress.

At this point, I am primarily concerned over the structure set up by FIRREA and the degree to which this structure may be impeding the RTC's progress in achieving resolutions for troubled thrifts. The RTC and the RTC Oversight Board have now been in existence for more than 6 months. Yet two seats on the Oversight Board remain vacant. This alone causes me to question the seriousness of this administration in resolving this crisis as quickly as possible.

No one anticipated that the RTC would have an easy job; no one expected the process to move forward without a few glitches. Yet it is troubling that there seems to be a fair amount of dissension between the RTC Oversight Board and the RTC. The Oversight Board was created to set overall strategy and policy, including the general policies for case resolutions, the management and disposition of assets, as well as to authorize the use of funds provided by the Treasury. Yet the RTC is authorized to act independently of the Oversight Board on case-specific matters. These contradictory responsibilities appear to have impeded the progress of the disposition process. When I go back and read the report language accompanying FIRREA, I too am confused over exactly where that leaves the RTC on a day to day basis.

While I do not object to the Oversight Board's efforts thus far, I question the necessity of requiring the RTC to regularly seek approval. While the intentions of FIRREA were good—that is the creation of the Oversight Board was designed to add an extra layer of supervision to the disposition process, it has set up a situation where the Executive Director of the RTC is forced to seek approval from a board, at this time only three-fifths staffed, with a host of other pressing responsibilities.

It is not surprising that thus far the resolution of insolvent thrifts has proceeded slowly, with the RTC acquiring failed institutions faster than it has been able to dispose of them. At this rate we cannot begin to expect that the task will be accomplished before the sunset date of December 31, 1996. Yet that is the pledge that we made to the American taxpayer with the passage of FIRREA. Congress passed this legislation and it is Congress' responsibility to ensure that it sets up a workable, efficient process.

If we have clogged the process with unnecessary layers of bureaucracy, now is the time to rectify our mistake. It is in the best interest of all parties present today to see that the RTC's mission is accomplished as expeditiously as possible. I trust that our witnesses will be candid about any problems they perceive to presently exist with the structure of and relationship between the RTC and the Oversight Board. I look forward to their testimony.

Thank you, Mr. Chairman.

The **CHAIRMAN**. Senator Gramm.

Senator **GRAMM**. Thank you, Mr. Chairman.

OPENING STATEMENT OF SENATOR GRAMM

Senator **Gramm**. Let me begin by congratulating the Oversight Board on one thing that they have done well. The Congress gave the RTC the power to engage in piracy, the power to take the assets of these failed thrifts, which represent our only hope of getting the taxpayer's money back, and to use those assets as part of a nonappropriated social welfare program.

On behalf of the 119 million taxpayers of America, I want to thank you for not taking advantage of the opportunity to pirate the assets of the people who put up this money. I think your decision to reject the option that was provided in the law was a sound one, and I think the American people, when they come to understand it, are going to be very grateful.

And so, let me begin by congratulating you on making the right decision in rejecting the idea of pirating the assets of the RTC to engage in creating a new social program.

Everybody has made a second point, and it is an important one, but I want to make it not just with regard to setting policy. I think it is very improtant that we set out a good program before we go charging off. But I think, once we go charging off, it is important that we move ahead quickly.

When we wrote this law, and I speak representing the State that has more of these problems than any other State and probably more than the next two or three combined—an honor that I would happily pass to anybody else—I was deeply concerned about what was going to happen when we sold all these assets.

I had this fear that we were going to have a fire sale on assets, selling off 25 percent of Austin, TX and huge percentages of the other major cities of my State, that real estate values were going to go through the floor, and that we were going to pull every bank, every savings and loan, down in the process.

I want to tell you, having watched the process now for 6 months, that that is no longer my chief concern. My concern is not dramatic action, my concern is inaction.

I am now concerned that the Federal Government is going to manage these assets in perpetuity; that we are going to have people in charge of asset disposition who have little economic incentive to sell the assets, people whose retirement will be vested in 5 years. In my opinion, if the RTC is still in existence 5 years from today, we will have seen it fail the American people and the American taxpayer.

I want to urge you to be bold. Go out and sell some of this property. Put it on the market. Get it into private hands, where private owners are paying local taxes, where people have an incentive to be efficient managers. And if that means taking losses to get the property into the private sector so it can be efficiently used, my opinion is, the long-term losses will be lower.

It is also critically important, as I see it in looking at my State, to be bold, whether prices start going up as you begin to sell the property or whether they start going down. And I think one of the reasons for being bold and putting property on the market is that, if it is clear you are doing that, you are going to create the psychology that "If you want a good buy you had better go in and buy now." My view is, anybody that buys this property in my State and has deep pockets and can hold it, is going to get rich.

On the other hand, if people believe that it is going to go down in price, they are going to wait. I do not want them to wait. And so I want to urge you not to get caught up in the "McClellan syndrome," where you have always got to have more troops, more money, more commitment, more time, more training, until finally the poor President in frustration asks, if you are not going to use the Army, if he could borrow it. [Laughter.]

I want to urge you to act boldly. And I just want to pledge, Mr. Chairman, that I am willing to support people that are willing to be bold. You are not going to get complaints from me if you get out and act decisively and try to get on with it, even if along the way you make some small mistakes. In my opinion, we will make fewer big mistakes if we act very decisively.

So again, Mr. Chairman, I just want to say that I support what they are trying to do; I think the committee does. We do not want to spend a lot of time dragging you up here for hearings. We want you to be doing the job, and I know that is what you want to do.

Thank you, Mr. Chairman.

The CHAIRMAN. Let me just say, Senator Gramm, on that point, I made a passing reference to this earlier, but I want to make a more detailed reference to it now.

The RTC has done a complete inventory of properties that it now holds, with an estimated book value of $15 billion, many of them, as you say, in your home State of Texas. It is 30,000 different pieces of property. It is now available in a catalog form, and I want everyone to see it in all the parts.

There are two sections on residential properties that summarize, by property, all of these holdings across the country, where they are, how somebody goes about getting in touch that is interested in wanting to buy them. The residential properties alone comprise these two volumes.

Then, there is a volume on affordable housing properties, which are a separate category. There is another one on commercial properties, that is about an inch thick. And then, there is another volume that just deals with raw land that has not been developed—again, I think a lot of it in your State. Now, this inventory is for sale today, as I understand it, and I am sure they will elaborate on it.

Anybody who wants a set of these volumes, to understand what is available and to come forward to offer a price for any one of these 30,000 properties, can get this set of volumes for $50. That is the cost to anybody that wants them. I am told, at last notice, that 100,000 sets of these have already been purchased by people in the country that want to start to buy these properties.

If somebody wants to buy this set of volumes to start going through here, to see what they would be interested in buying, they can do so by calling a toll-free number, which is 1-800-431-0600.

So I do not know whether C-Span——

Senator HEINZ. Mr. Chairman, would you repeat that? [Laughter.]

The CHAIRMAN. I think we have a buyer here.

The number is 1-800-431-0600. And so anybody in the country who is interested in investing in a piece of Texas real estate, or the properties of other places, can have this come by return mail.

Senator **Gramm**. And it is a toll-free number? [Laughter.]

The **Chairman**. That is what we are told. [Laughter.]

Senator Sarbanes.

OPENING STATEMENT OF SENATOR SARBANES

Senator **Sarbanes**. Thank you very much, Mr. Chairman. I will be brief.

First of all, I want to commend you for calling this hearing within a week of the return of the Senate in session for the second session of the 101st Congress. I assume this is but the first in a series of regular oversight sessions which this committee will be holding with the RTC and its Chairman and its Oversight Board.

The **Chairman**. That is right.

Senator **Sarbanes**. Second, I want to say to the members of the Board and to the Chairman of the RTC, I do not envy your task. I have been sitting here this morning listening while you get almost diametrically opposing views from members of the committee as to the direction in which you should be proceeding.

And in fact, if I heard correctly, only a moment or two ago we heard diametrically opposing views from the same member, in terms of a change in this view over time. So that, had you done earlier what he recommends that you do today, he would have been sharply critical of you. Of course now he has a different perspective, but I assume that it is quite possible that that perspective could yet change again in the future. So I appreciate the position in which you find yourselves.

Third, the Congress did pass a bill, and there are provisions in it. I do not think it is within the Board's authority simply to ignore those provisions. And therefore, I think the provisions that involve trying to move some of this stock into low- and moderate-income housing are not something that simply can be discarded by the Board, and I would commend your attention to those aspects of the legislation.

Finally, I do not understand, given the seriousness of this problem and the necessity to address it, why the President has yet to fill out the personnel team to deal with it. The legislation called for two independent members of the Oversight Board. That legislation was passed in August. The Senate was here until close to the end of November. We are now back now at the end of January. To my understanding, the nominations of the two independent members of the Oversight Board have not yet been made.

Now, one is led to ask, what is happening here? I mean, we think the Oversight Board is an important part of the statutory scheme. We understand that the three of you are trying to meet your responsibilities. You are supposed to have, in addition, two independent members on this Board. Those nominations have not yet been made.

Why? What is the hold-up downtown is sending those nominations?

The legislation established a Federal Housing Finance Board, as I understand it, a five-member board. The Secretary of HUD I think is a member of that Board. He is the only one of the five members put into place. Three regular members of the Federal Housing Finance Board are not yet nominated by the President. The consumer representative to go on the Federal Housing Finance Board, not yet nominated.

Now, are we serious about dealing with this problem? It seems to me, the first step in proving your seriousness is to put your team into place, to fill out the positions that have been provided by the legislation to address this issue.

The legislation expanded the Board of Directors of the FDIC by one member, if I am correct. That was back in August. My understanding is, that nomination has not yet been made. The inspector general of the RTC—is there an inspector general as yet? My understanding is, no inspector general, as yet.

So, Mr. Chairman, I just close this short opening statement by asking, when can the Senate expect to receive these nominations? When are we going to see a seriousness with respect to putting into place the team to address this pressing issue that the magnitude of this problem warrants?

The CHAIRMAN. Thank you, Senator Sarbanes.

Senator Pressler.

Senator PRESSLER. Mr. Chairman, I shall submit my statement for the record.

My statement does talk about what Chairman Seidman—he has stressed the importance of making advances to replace the high cost funds of RTC conservatorships, and looking for new ways to limit the cost of the problem.

I am wondering, might this include some relaxation of capital standards, or forbearance for the more healthy thrifts? And my opening statement addresses that. I would like to hear the panel's views on that.

In the interest of time, I shall submit my statement for the record.

The CHAIRMAN. Thank you, Senator Pressler. We will make it a part of the record.

[The prepared statement of Senator Pressler follows:]

PREPARED STATEMENT OF SENATOR PRESSLER

Thank you. Mr. Chairman, I first wish to commend you for scheduling the hearing this morning with respect to the strategic plan for the Resolution Trust Corporation [RTC] which the Oversight Board adopted the end of last year. We also will be hearing today from our distinguished witnesses about the activities of the Board and the RTC in carrying out the objectives of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 [FIRREA].

Of special concern is the question of whether the organizational structure that is provided by FIRREA operates effectively. Is it too cumbersome with decision making unduly delayed by officials who do not have the responsibility for the day-to-day operations of the corporation? As crucial and involved as the problems are we should provide the best possible vehicle for getting the job done. I would hope that solutions could be found that do not require amending FIRREA, but if it cannot be accomplished administratively, I submit we should consider amending the act.

I join in welcoming each of the distinguished witnesses to the committee and look forward to hearing their testimony on these important matters.

The CHAIRMAN. Senator Dixon.

OPENING STATEMENT OF SENATOR DIXON

Senator Dixon. Well, first of all, Mr. Chairman, I want to share with my colleagues the very strong feelings I have about the fine work you have done in connection with this legislation, and the fact that you have called these oversight hearings.

You and the ranking member have literally spent hundreds and hundreds and hundreds of hours on this issue. And as you know, we spent a great deal of time as a committee last year on this subject matter. And I think you know, as the Chairman and as my friend, that somewhere along the line I lost my enthusiasm for this work, when I saw the direction in which we were moving last year.

Some others on this panel I think shared my view. In the end, I thought the Senate product was substantially better than the House product. But the final bill that we passed I thought was inadequate to the task, and one that did not bear my imprimatur, so that I feel no sense of parenthood for the product we are dealing with now.

But I want to say this. I share the views of my colleague from Maryland, the distinguished senior Senator from Maryland, and others who have expressed concerns. I think we are terribly slow getting out of the starting gate, and I think we are drowning in confusion. And I think that is the feeling by the public, when we go home and share our thoughts with our constituency groups out there.

I commend the Chair and the ranking member for redirecting our attention to this whole subject matter. But I would want to leave the very firm impression with my colleagues on the committee and those we are dealing with here that most of us are deeply dissatisfied with the way this thing is progressing so far.

I congratulate again the Chair, who has spent so many hundreds of hours, and the ranking member, for their devotion to the cause. And while I am not at all pleased with the product, I think that what we have got, we have got to make work the best we can.

Mr. Chairman, I ask your consent to place my statement in the record, and I urge you to continue in the fullest way your development of the thesis that is under consideration.

The Chairman. Thank you, Senator Dixon.

[The prepared statement of Senator Dixon follows:]

Prepared Statement of Senator Dixon

Mr. Chairman, I am pleased to be here this morning as the Senate Banking Committee continues its oversight of the Resolution Trust Corporation. I commend the chairman for his continued attention to this matter and look forward to the testimony from John Robson, Jack Kemp, and Alan Greenspan of the Oversight Board and L. William Seidman of the RTC.

Last January 31, in a speech on the Senate floor, I set out several principles that I thought ought to guide the resolution of the savings and loan crisis. Among other things, I urged a cost-effective solution to the problem and a plan which placed as much of the financing burden as possible on the savings and loan industry. I emphasized that fast action was critical to minimizing costs. The progress of the RTC to date is troubling in light of these principles. The pace of the resolutions is much slower than anticipated while costs are escalating much faster. The taxpayer will ultimately bear the burden of our mistakes.

This crisis raises several fundamental issues. My foremost concern is whether the current agency structure is adequate to complete the task at hand. The Treasury, who recommended the current structure, must take responsibility for its implementation. Even our panel must agree that the RTC has been slow getting out of the starting gate in resolving cases. We continue to hear reports of confusion as to who is making policy decisions. The fact that it took over 4 months to issue a strategic plan evidences this confusion. We must resolve these problems. The efficient operation of the RTC lies at the heart of the future success of the cleanup operation.

Other questions demand answers as well. What other factors have contributed to the slow pace of resolutions? What are the most cost-effective means of correcting them at the lowest cost to the taxpayer? Is the RTC's demand for working capital necessary and is there a clear-cut distinction between working capital and other costs? Can we accurately formulate new assumptions in order to provide new projections of the ultimate cost of the cleanup?

I recognize that the Board and the RTC face a monumental task. I hope that this panel can provide us with some more definite answers today. While there are many other subsidiary issues which must be addressed in time, I urge this distinguished panel and my colleagues not to lose sight of the primary goal which brings us here today: Finding the most efficient and cost effective solution to the savings and loan crisis and to ease the financial burden of the taxpayer.

The CHAIRMAN. Senator Roth.

Senator ROTH. Mr. Chairman, I am looking forward to hearing from the distinguished panel. Thank you.

The CHAIRMAN. Before we begin I have statements from Senators Sasser and Sanford.

PREPARED STATEMENT OF SENATOR SASSER

The administration has conducted a protracted internal debate on how best to resolve the working capital issue, only to admit in its 1991 budget that it has omitted estimates of such expenditures for fear of affecting the Gramm-Rudman-Hollings deficit calculation. If one thing is clear from the savings and loan debacle it is that delay in resolving the crisis has contributed dramatically to its cost. Thus, this artificial debate over GRH will in all likelihood further increase the cost of the savings and loan bailout to the taxpayers.

Previously, the administration had said it was undecided over which working capital option to pursue, and for this reason was not including estimates in the budget. However, the President makes clear in his budget submission that working capital estimates were instead intentionally omitted because of GRH. The fact that the Administration believes that it can exempt such spending from the Gramm-Rudman-Hollings baseline deficit is irrelevant. The President has a statutory obligation under 31 U.S.C. 1105(a)(5) to include all estimates of government expenditures in the budget.

Separate and apart from the issue of budget treatment, the provision of working capital to the RTC raises the possibility that such funds could mask the actual cost of the savings and loan bailout. Working capital should in theory be fully recouped upon the sale of assets. If, however, assets are overvalued, and if they deteriorate in quality while they are held, it is possible that their sale may not be sufficient to repay the financing. If this is the case, the Treasury, and the taxpayers, will have to make up the difference, well after the $50 billion provided in FIRREA is expended.

Furthermore, the availability of enormous and unfettered quantities of working capital to purchase and hold assets could potentially decrease the incentive to sell assets as quickly as possible. Should this occur assets could deteriorate in value over their holding period, and will not be sold for a sufficient price. Given historic problems with real estate appraisals, and the uncertain future of real estate markets generally, working capital funds may not be fully recovered, increasing the cost of the bailout.

It appears that the administration has chosen the appropriate means of raising working capital—borrowing from the FFB. This will provide maximum flexibility and will not unduly increase the already enormous cost of the savings and loan bailout. However, the administration's arguments for excluding working capital needs from the budget are not persuasive. Instead, the budget treatment ignores substantial Federal needs which must be acknowledged and addressed forthrightly.

PREPARED STATEMENT OF SENATOR SANFORD

Thank you, Mr. Chairman. I would also like to thank our distinguished panel of witnesses for appearing before us today to review the activities to date of the Resolution Trust Corporation [RTC]. I would also like to commend your efforts to date in getting the RTC up and running in such a short amount of time and to thank you for the thorough reports you have presented to us this morning.

Certainly before the ink was dry on the legislation creating the RTC and its Oversight Board, stories appeared in the press regarding the impossible task facing the RTC. An editorial last fall in the Wall Street Journal depicted it as follows:

"When the RTC reaches full manhood, it will be a wonder to behold. Assigned to take over and dispose of assets of seized S&Ls, it will become the world's largest 'bank,' very loosely defined. Assets could reach a nominal value of $300 billion to $400 billion. It will employ some 4,000 people, most of whom will manage contracts with private specialists in asset management and disposal. Lawyers and accountants will love it."

The article goes on to describe the conflicting duties of the RTC and concludes that taxpayers can look for more and more waste of their money. Now I would certainly hope that the conclusion and even some of the predictions the Wall Street Journal makes will not come true, but those type of statements underscore the tremendous task you gentlemen face in overseeing the RTC.

I think a number of concerns have been expressed at hearings last week and in the press. One concerns the speed at which resolutions are taking place, another focus on the need of the RTC for working capital and the last focuses on whether the $50 billion authorized in last year's FIRREA legislation will be sufficient to do the job, now that we have a somewhat better fix on the magnitude of the problem. I hope we can focus some of our discussion this morning on those and related issues.

In looking at these issues, it remains clear that your main mission is to set up a structure and strategic plan that will permit the sale of dead or dying thrifts and will encourage buyers for assets of bankrupt institutions. I don't think any of us underestimate the difficulty of that task. However, I think we also share the concerns expressed during consideration of this legislation and underscored in numerous articles about the RTC—we must not let this become another bureaucracy run amok, rife with scandal or charges of favoritism.

I am afraid that the potential for abuse is as immense as the task you face. I think we all have learned some very painful lessons from the FSLIC's problems and the scandals at HUD. One of those lessons is that we cannot confuse deregulation with desupervision and the other is that constant oversight and proper audits are imperative to ensuring that taxpayer funds are well spent. I know you share our concerns regarding the potential problems and we appreciate your efforts to oversee the RTC's activities in a professional and efficient manner.

I know we all look forward to your report on your efforts to date and to working with you time and time again in the future to ensure that the RTC has the tools it needs to carry out its mission.

Thank you.

The CHAIRMAN. Gentlemen, Mr. Robson, you are serving as the Acting Secretary of the Treasury, as I understand it, and you are here to represent the Treasury Department in that responsibility, a very important one. And so we would be pleased to hear from you at this time.

STATEMENT OF JOHN ROBSON, DEPUTY SECRETARY, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Mr. ROBSON. Thank you, Mr. Chairman, and members of the committee.

The CHAIRMAN. And could I ask you to pull the microphone just a little closer. I want to make sure everybody behind you can hear you as well.

Mr. ROBSON. Thanks, Mr. Chairman. Is that better?

I am here this morning as Acting Chairman of the Oversight Board. I am accompanied by Board members Alan Greenspan, Chairman of the Federal Reserve Board, and Jack Kemp, Secretary of the Department of Housing and Urban Development. Also with us is Dan Kearney, who is President and Chief Executive Officer of the Oversight Board.

The members of the Board appear before you, as required by the Financial Institution Reform, Recovery, and Enforcement Act of 1989, otherwise known as "FIRREA," to describe the strategic plan for the Resolution Trust Corporation which the Oversight Board submitted to Congress on December 31, 1989.

I would like, Mr. Chairman, to submit the strategic plan for the record.

The CHAIRMAN. We will make it a part of the record.

Mr. ROBSON. Thank you.

Before describing the strategic plan, let me address several key issues. FIRREA established two new entities with well defined roles: The Oversight Board, to oversee and set policy for the Resolution Trust Corporation; and the Resolution Trust Corporation, the operating arm to manage and resolve insolvent thrifts.

Congress vested the Oversight Board with the authority to make policy, review performance, and approve financing for the RTC. As the operational entity, the RTC manages and resolves all thrifts that fail between January 1, 1989 and August 9, 1992, and reviews for possible revision the case resolutions completed by the Federal Savings and Loan Insurance Corporation during 1988.

We believe the working relationship between the Oversight Board and the RTC has developed in a positive way. The Oversight Board has developed policies and procedures for thrift resolution in consultation with the RTC, and has provided financing as it has been needed.

The RTC has resolved thrifts and disposed of assets following guidelines consistent with the Oversight Board's broad policy direction. When Oversight Board policy is not operative, RTC follows applicable FDIC policies and procedures.

I know of no instance in which the working relationship between the Oversight Board and the RTC has thwarted progress toward our common goal of carrying out the mandates of FIRREA.

Since August 9, 1989, the RTC has resolved 40 thrifts with approximately $12 billion in deposits. In addition, the RTC has advertised for bids on 9 large thrifts in early January, and recently announced that it was seeking bids on another 43 institutions.

While the Oversight Board and the RTC expect the pace of resolution to pick up in the coming months, we believe that the initial phase has been progressing reasonably well, in view of the desire to involve the maximum number of potential bidders, the number of thrifts, the start-up nature of the operation, and the need to develop and implement new policies.

Another issue that continues to receive attention is whether FIRREA included adequate resources to address the magnitude of thrift losses. Before addressing this issue, let me briefly review the amount of resources that FIRREA actually provided, which totals over $100 billion for past, present, and future thrift problems.

First, Government funds were committed to cover the cost of past FSLIC transactions which are currently estimated at a current value of $40 billion. Second, FIRREA provided the RTC with $50 billion to pay for the existing problem; that is, net losses associated with thrifts that failed from January 1, 1989 until August 9, 1992. To date, RTC has spent an estimated $6.4 billion to pay for these losses.

Finally, FIRREA committed up to $32 billion in Government funds to the Savings Association Insurance Fund, SAIF, to pay for future problems. Of that $32 billion, $16 billion could become available as soon as October 1, 1992, just about 2½ years from now.

As we said in testimony last October, we do not yet know whether the $50 billion provided to the RTC will ultimately be adequate, because of the many variables that continue to exist. These include the pattern of interest rates, the performance of local real estate markets, the general condition of regional economies and how effectively the RTC performs its assignment of resolving thrifts and selling assets.

As you know, the RTC has recently suggested that the $50 billion is unlikely to be adequate for its ultimate case load, based in part on its estimates of losses in thrifts currently in conservatorship. We are examining the data on which these estimates are based, as well as data provided by the Office of Thrift Supervision, on a regular basis, concerning additional thrifts OTS currently classifies as likely to fail.

As the resolution process goes forward, we will share with Congress data we believe to be useful and reliable. When we become convinced that it is necessary to either reallocate to earlier periods resources from the $32 billion provided in FIRREA for post-1992 losses, or to provide resources in addition to such reallocation in order to fill the Government's full faith and credit commitment, we will request appropriate action by Congress in a timely manner.

As we see it, however, the important question at this time is whether the RTC has adequate resources to tackle the immediate problem it confronts. And the answer to this question is clearly, yes, provided the RTC obtains adequate financing for temporary working capital, as we discuss below.

Put another way, we do not know what the RTC or the Oversight Board would do differently now, even if the cost of the S&L cleanup were projected to be somewhat higher.

The focus now should be on moving forward to get the job done, and I think that echoes and confirms the sentiments that I have heard from you and your colleagues today, Mr. Chairman.

As mentioned above, and as authorized by FIRREA, the RTC will need temporary working capital. In essence, working capital is the temporary use of cash that is raised through borrowings fully supported by assets. The primary purpose of working capital is to permit the RTC to acquire problem assets from a failed institution, and carry them until later sale. The borrowed funds used for working capital are supported by the assets acquired, and as the assets are sold, the working capital loans are repaid.

This working capital financing is completely distinct from the $50 billion provided under FIRREA to pay for thrift losses. The amounts borrowed for working capital are temporary, since they would be repaid by the sale of the assets purchased by the RTC. In contrast, the $50 billion is money that is spent permanently, since it covers the net losses of RTC thrifts after assets are sold and liabilities repaid.

Working capital borrowing does not increase the $50 billion in resources available to the RTC to pay for the ultimate cost of the thrift clean-up, because every dollar borrowed for working capital is supported with tangible assets.

A second use of working capital is to temporarily reduce the expensive borrowing cost of thrifts in conservatorships until the time that they are actually resolved by the RTC, which achieves direct savings for the taxpayer. Finally, working capital may be needed to provide emergency liquidity on a temporary basis to thrifts and conservatorships.

Although amounts borrowed and used for working capital are only temporary, concerns have been expressed that they will be used to increase the $50 billion provided for net thrift losses. These concerns were specifically addressed by Congress in FIRREA.

While Congress authorized the RTC to borrow money for working capital, it specifically included an asset base borrowing cap to protect the taxpayer. This cap limits RTC borrowing to 85 percent of the fair market value of the RTC assets, which ensures that the tangible assets are adequate to pay off working capital obligations. Working capital borrowing therefore is self-liquidating through subsequent asset sales.

It is extremely difficult to predict exactly how much working capital will be required over the life of the RTC. Although rough estimates by the RTC suggest that such needs could peak somewhere between $40 billion and $100 billion. The variables include, among others, the amount of assets that will be actually acquired by the RTC, the pace of asset sales, the number and size of institutions that the RTC ultimately resolves, the amount of high-cost funds replaced, and the emergency liquidity needs.

RTC's recent estimates indicate that between $27 billion and $44 billion of working capital might be needed during calendar year 1990, again depending on the number of thrifts placed on conservatorships and the pace of asset sales out of receivership. It should be noted that this 1990 estimate does not include potential financing for high cost fund replacement.

Both the Oversight Board and the RTC have recently advised Congress that, in order to avoid interrupting the case resolution program, working capital should be made available by the end of February.

We are currently considering three approaches for financing working capital needs, whether alone or in combination. They are: RTC borrowing from the Federal Financing Bank; borrowing from the Federal Home Loan banks, with some form of credit enhancement to reduce costs; and lowering the cost of current brokered deposits through sales to institutional investors.

All of these approaches are described in more detail in our written statement, including the legal and practical issues that must still be resolved before proceeding with any of them. We will also establish an accounting system that segregates working capital from funds spent for case resolutions.

We expect to finalize a plan and begin providing working capital to the RTC in a few weeks. However, no working capital obligations will be issued until we have fully briefed the Congress on our plans.

After finalizing an adoption of the working capital approach, the determination of the treatment of working capital borrowing for budget purposes will be made by the administration in consultation with Congress. The President's budget fully discusses these issues, and commits to work with Congress to devise an appropriate approach.

Mr. Chairman, I would now like to summarize briefly key elements of the RTC strategic plan. The strategic plan includes goals, objectives, and implementing procedures. The goals establish direction for RTC in six areas: case resolution, asset disposition, affordable housing, conflicts of interest in ethical standards, external relations, and administration.

The plan's objectives provide more specific direction with respect to each goal. Finally, consistent with FIRREA's concept that the RTC is the operating entity, the plan generally relies on the RTC to develop the detailed implementing procedures to carry out the strategic plan's goals and objectives.

In addition to this general framework, and because the Oversight Board is acutely aware of the need to husband the resources that Congress has made available, we adopted a set of expenditure principals as part of the strategic plan, to guide the use of funds for purposes other than case resolution.

Accordingly, when considering the expenditure of funds for other programs authorized by the statute, the Oversight Board has required that it be provided with a cost estimate of the program and other relevant information. If the program is approved, the RTC is required to monitor the implementation of the program, and provide regular reports, including on its cost to the Oversight Board.

Let me now briefly describe some key sections of the strategic plan, beginning with case resolution. My written statement provides considerably more detail for each of the sections.

The strategic plan directs the RTC to manage thrifts in conservatorship in a manner that reduces the RTC's risk exposure, reduces operating losses, pays down high rate liabilities, and in general prepares them for eventual sale and liquidation.

The prioritization schedule is also clearly needed, because the RTC is responsible for many thrifts and cannot resolve them all simultaneously. The strategic plan requires the RTC to prioritize institutions for resolution at a minimum by quartiles.

In doing so, the Oversight Board stated its view that the most important factor to consider is the rate of deterioration in the net worth of an institution. Institutions with the highest operating losses and the greatest erosion in franchise value should be given first priority.

The Oversight Board also believes that a significant way to reduce the cost of resolutions is to encourage active participation in the resolution process by all qualified bidders. The strategic plan instructs the RTC to develop an open and widely publicized bidding procedure.

The second key element of the plan addresses asset disposition. The sheer number of assets to be worked out will require that the RTC rely heavily on the private sector and private sector contractors for the management and disposition of these assets, subject to general oversight and audit by the RTC.

The strategic plan calls for the RTC to establish annual targets for utilization of the private sector, and to report on its performance using a variety of measures. The strategic plan also calls for the RTC to use a variety of incentive contracts as a means of ensuring that the Government receives the maximum net present value return on its asset.

To assure that the RTC employs the services of minority and women firms, the strategic plan asks the RTC to create a minority and women outreach program, which we are advised was just adopted. Based on RTC cost estimates, the Oversight Board authorized an expenditure by the RTC of $6 million in total for this program.

FIRREA requires that eligible affordable housing properties first be offered to qualified purchasers for 90 day through clearinghouses, administered by State housing finance agencies, the Office of Community Investment, or other divisions of the Federal Housing Finance Board, and certain national nonprofit organizations.

The strategic plan provides that no later than March 30, 1990 the RTC should develop guidelines and procedures that implement the low- and moderate-income provisions of FIRREA and maximize the effectiveness of this right of first refusal period.

Before March 30, 1990, to avoid keeping needed housing off the market and to avoid deterioration of the eligible properties while comprehensive guidelines are being developed, the RTC may sell eligible properties after developing interim guidelines for review by the Oversight Board. These guidelines have been submitted to the Oversight Board for review, and the Oversight Board has given the RTC authority to proceed under the guidelines as to a limited number of single-family properties.

The Oversight Board will continue to review these guidelines, and will have additional comments promptly.

The interim guidelines authorize pilot projects that test various program concepts but do not provide direct subsidies. The strategic plan requests that the RTC report to the Oversight Board on the results of its interim marketing efforts by May 30, 1990.

The Oversight Board will carefully monitor the RTC's marketing efforts. And if the Board determines that the mandatory right of first refusal period alone is not effective, then the Board will determine if direct subsidies or other approaches are needed.

In early October 1989, the RTC issued an interim statement of principles of ethical conduct for independent contractors. Subsequently, on November 28, 1989, the Oversight Board and the RTC published a proposed rule for public comment that would establish minimum qualifications, ethical standards of conduct, and restrictions on the use of confidential information for independent contractors who seek to contract to provide services for the RTC.

Pending issuance of final rules, the FTC standards of conduct regulations generally apply to employees of the RTC and the Oversight Board.

In conclusion, Mr. Chairman, the Oversight Board regards the strategic plan as a living document. And as the Board and the RTC develop more experience, issues will arise that will require new policies and directions. As a result, the Board expects to update and refine the strategic plan on a periodic basis.

Thank you.

The CHAIRMAN. Thank you very much.

[The prepared statement of John E. Robson follows:]

STATEMENT OF
DEPUTY SECRETARY JOHN E. ROBSON,
ACTING CHAIRMAN OF THE
OVERSIGHT BOARD FOR THE RESOLUTION TRUST CORPORATION
BEFORE THE
COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE
January 31, 1990

Good morning, Mr. Chairman and members of the Committee. My name is John E. Robson. I am Deputy Secretary of the Department of the Treasury and will be speaking to you this morning as Acting Chairman of the Oversight Board.

I am accompanied by Board members, Jack Kemp, Secretary of the Department of Housing and Urban Development, and Alan Greenspan, Chairman of the Federal Reserve Board, and by the President and Chief Executive Officer of the Oversight Board, Daniel Kearney.

On December 31, 1989, the Oversight Board issued its strategic plan for the Resolution Trust Corporation (RTC). I would like, Mr. Chairman, to submit the strategic plan for the record.

The members of the Board appear before you as required by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA), to describe the strategic plan and the policies and procedures that it establishes for the RTC. We are also pleased to have this opportunity to speak to you about our activities to carry out the objectives of FIRREA.

SUMMARY

The purpose of this statement is to describe the strategic plan, the policies and procedures that it establishes for the RTC, and the activities undertaken by the Oversight Board to carry out the objectives of FIRREA. Before discussing the strategic plan, the statement touches on several issues of interest to Congress including: the role of the Oversight Board in the FIRREA process; the adequacy of $50 billion to cover the net losses of failed thrifts over the next three years; the pace of resolution; and the use of working capital.

FIRREA established two new entities with distinct roles: the Oversight Board, with responsibility for oversight and policy governing the Resolution Trust Corporation, and the Resolution Trust Corporation, the operational arm with responsibility for managing and resolving insolvent thrifts and disposing of their assets.

The working relationship between the Oversight Board and the RTC has developed in a positive way since the two agencies were created last August. Both the Oversight Board and the RTC have made good progress in building their new organizations. The Oversight Board has developed policies and procedures for thrift resolution in consultation with the RTC and has provided financing as it has been needed; and the RTC has resolved thrifts and disposed of assets following guidelines consistent with the Oversight Board's broad policy directions.

Since August 9, 1989, the RTC has resolved 40 thrifts with approximately $12 billion in deposits. While the Oversight Board and the RTC expect the pace of resolution to pick up in the coming months, we believe that the initial phase of the resolution process is progressing reasonably well in view of the start-up nature of the operation, the need to develop and implement new policies, and the desire to involve the maximum number of potential bidders.

Questions continue to arise about whether FIRREA included adequate resources to address the magnitude of thrift losses. The important question at this time is whether the RTC has adequate resources to tackle the immediate problems it confronts. We believe the answer to this question is clearly yes--provided the RTC obtains adequate financing for temporary working capital.

The RTC will need temporary working capital. In essence, working capital is the temporary use of cash that is raised through borrowings fully supported by assets. While Congress authorized the RTC to borrow money for working capital, it specifically included a borrowing cap which limits RTC borrowing to 85 percent of the fair market value of RTC assets.

It is extremely difficult to predict exactly how much working capital will be required over the life of the RTC, although rough estimates by the RTC suggest that such needs peak somewhere between $40 and $100 billion. Estimates indicate that between $27 and $44 billion will be needed during calendar year 1990 depending upon the number of thrifts placed in conservatorship and the pace of asset sales out of receivership. It should be noted that this 1990 estimate does not include potential financing for high cost funds replacement. We expect to begin providing working capital to the RTC by the end of February. However, no working capital obligations will be issued by the RTC until we have fully briefed the Congress on the Oversight Board's plans.

One of the essential tasks undertaken by the Oversight Board has been the preparation of a strategic plan for the RTC. The strategic plan establishes policies, goals, and objectives for a broad range of the RTC's operations. The strategic plan's goals establish direction for the RTC in six areas: case resolution, asset disposition, affordable housing, conflicts of interest and ethical standards, external relations, and administration. The strategic plan's objectives provide more specific direction with respect to each goal. Consistent with FIRREA's concept that the RTC is the operating entity, the strategic plan generally relies on the RTC to develop the detailed implementing procedures to carry out the strategic plan's goals and objectives.

Because the Oversight Board is acutely aware of the need to husband the resources that Congress has made available, it has adopted a set of expenditure principles to guide the use of funds for purposes other than case resolution. Accordingly, when considering the expenditure of funds for other programs authorized by the statute, the Oversight Board has required that it be provided with a cost estimate of the program and other relevant information. If the program is approved, the RTC is required to monitor the implementation of the program and provide regular reports (including its costs) to the Oversight Board.

The RTC is responsible for the prudent operation of its caseload of institutions in conservatorship. Under the strategic plan, the RTC is to manage thrifts in conservatorship in a manner that reduces the RTC's risk exposure, reduces operating losses, pays down high-rate liabilities, and in general, prepares them for eventual sale and liquidation.

A prioritization schedule is clearly needed. The strategic plan asks the RTC to prioritize institutions for resolution. In doing so, the Oversight Board stated its view that the most important factor to consider is the rate of deterioration in net worth of an institution.

The strategic plan encourages competition among bidders to determine the method for resolving a particular institution. The Oversight Board believes that potential acquirers should be allowed to bid on a variety of resolution structures (e.g., whole thrift, clean thrift, branch sales), and the RTC should select the least-cost solution based on the bids received.

The Oversight Board wants minority-owned thrifts to continue as minority-owned institutions and approved a program to facilitate their continuation as minority institutions that was consistent with its expenditure principles. Accordingly, the strategic plan provides that the RTC may assist a qualified minority acquirer by postponing for up to nine months the closing of a transaction until the acquirer finds permanent capital or by providing up to nine months of bridge financing on up to two-thirds of the required capital for the acquired institution.

Assets not sold as a part of a thrift resolution will have to be disposed of separately by the RTC. Approximately one-half of the assets managed by the RTC in conservatorships and receiverships are currently comprised of single-family mortgages, mortgage-backed securities and other liquid assets. Hardest to dispose of will be the real estate assets, where the risks posed by various claims will be compounded by the need to assure clean title to prospective purchasers. The strategic plan contemplates that the RTC will rely heavily on private sector contractors in moving promptly to dispose of these assets.

It is the Oversight Board's policy that the RTC should proceed with the prompt and orderly disposition of assets and avoid holding properties (except to comply with the affordable housing right-of-first-refusal marketing provisions in FIRREA).

The strategic plan provides that, no later than March 30, 1990, the RTC should develop guidelines and procedures that implement the low- and moderate-income provisions of FIRREA and maximize the effectiveness of this right-of-first-refusal period. While the strategic plan does not at this time permit the use of direct subsidies by the RTC for the marketing of eligible properties, the Oversight Board will carefully monitor the RTC's marketing efforts to determine the degree to which FIRREA's affordable housing objectives are being achieved. If the Board determines that the mandatory right-of-first-refusal period is not meeting the housing objectives of FIRREA, then the Board will determine if direct subsidies are necessary to meet such objectives; the appropriate form of the subsidies; and the total amount of subsidy, if required.

Under FIRREA, the Oversight Board and the RTC must issue regulations on conflicts of interest, ethical responsibilities, and post employment restrictions, applicable to their employees, that are no less stringent than the employee conduct regulations of the FDIC. By early January 1990, both the RTC and the Oversight Board published proposed rules for comment. Pending issuance of final rules, the FDIC's standards of conduct regulations apply to employees of RTC and the Oversight Board, except for employees detailed from other agencies, who are subject to the rules of such agencies.

The National and Regional Advisory Boards are being established by the Oversight Board to provide an avenue for communications with the public regarding the RTC's guidelines and procedures for the sale or disposition of real property assets. The Board expects the advisory boards to be functioning by the spring of 1990.

In order to address environmental concerns, the RTC is operating under current FDIC policies regarding compliance with the National Environmental Policy Act, the Endangered Species Act, the Council on Environmental Quality, and executive orders regarding floodplains and wetlands.

CURRENT ISSUES

Before I describe the strategic plan, I would like to touch on several issues of interest to Congress. These include: the role of the Oversight Board in seeing that failed thrifts are resolved and their assets disposed of in an effective and efficient manner; the adequacy of $50 billion to cover the net losses of failed thrifts over the next three years; the pace of resolution; and the use of working capital.

Organizational Structure for Thrift Resolution

When Congress considered an organizational structure for thrift resolution, it had a number of options. It could have assigned the task to a new or existing agency within the Executive Branch, so that the Administration would be solely responsible for this complex assignment. Or, it could have given the entire job to an independent agency like the Federal Deposit Insurance Corporation (FDIC). Instead, Congress chose--and wisely, I think, in view of the unprecedented scope and magnitude of the problem--to create an organizational structure that combined the elements of accountability and operational strength and expertise.

FIRREA established two new entities with well-defined roles: the Oversight Board, to oversee and set policy for the Resolution Trust Corporation, and the Resolution Trust Corporation, the operational arm to manage and resolve insolvent thrifts.

The Oversight Board consists of five members: the Secretary of the Treasury who serves as Chairman, the Secretary of Housing and Urban Development, the Chairman of the Federal Reserve Board, and two independent members to be appointed by the President and confirmed by the Senate. Its day-today operations, conducted by a small staff, are managed by a President who is also the Board's Chief Executive Officer.

The mission of the Oversight Board, as defined by FIRREA, is:

- developing overall RTC policies and goals;
- establishing overall RTC financial policies and goals;
- reviewing the guidelines and procedures set by the RTC to achieve its objectives;
- reviewing the RTC's overall performance of its task; and
- authorizing RTC use of Treasury funds and Resolution Funding Corporation borrowings.

The Board oversees the RTC's operations; and to this end, Congress vested it with the authority to make policy, review performance, and approve financing.

The RTC was created as the operational entity to manage and resolve all cases involving depository institutions that were insured by the Federal Savings and Loan Insurance Corporation (FSLIC) before the enactment of FIRREA and for which a conservator or receiver is appointed between January 1, 1989, and August 9, 1992. The RTC is also responsible for reviewing and, if appropriate, revising the case resolutions completed by FSLIC during 1988 and 1989 and for dissolving the Federal Asset Dispositior Association (FADA). Subject to the review of the Oversight Board, the RTC can adopt the operating rules and procedures that it needs to carry out its mission.

Under FIRREA, the RTC is bound to manage and resolve the institutions that come under its jurisdiction and to dispose of any residual assets in a manner that:

- maximizes return and minimizes loss;
- minimizes the impact on local real estate and financial markets; and
- maximizes the preservation of the availability and affordability of residential property for low- and moderate-income individuals.

The Board of Directors for the FDIC also serves as the Board of Directors for the RTC and the manager of its day-to-day operations which are supervised by an Executive Director.

The staff assigned to the RTC are organized into two principal divisions. One deals with thrift resolutions and operations, and the other, with asset and real estate management. Additional staff perform support services in headquarters, but the bulk of the staff under the direction of the RTC are distributed throughout four regions with offices in Atlanta, Kansas City, Dallas, and Denver.

We believe that the working relationship between the Oversight Board and the RTC has developed in a positive way since the two agencies were created last August. Both the Oversight Board and the RTC have made good progress in building their new organizations. The Oversight Board has developed policies and procedures for thrift resolution in consultation with the RTC and has provided financing as it has been needed; and the RTC has resolved thrifts and disposed of assets following guidelines consistent with the Oversight Board's broad policy directions. I know of no instance in which the working relationship between the Oversight Board and the RTC has thwarted progress toward our common goal of carrying out the mandates of FIRREA.

Pace of Resolution

Since August 9, 1989, the RTC has resolved 40 thrifts with approximately $12 billion in deposits. In addition, the RTC advertised for bids on nine large thrifts in early January and recently announced that it was seeking bids on another 43 institutions.

The Oversight Board believes that the pace of resolution to date has been creditable in view of the start-up nature of the operation, the need to develop and implement new policies, and the desire to involve the maximum potential number of bidders. Let me emphasize that the inclusion of a larger number of bidders necessarily slows the pace of resolutions by requiring longer bid response periods, by extending due diligence periods, and by increasing the complexity of the bid evaluation process. In sum, while the Oversight Board and the RTC expect the pace of resolution to pick up in the coming months, we believe that the initial phase of the resolution process is progressing well and that it is better to do the job right rather than just fast. With appropriate policies and procedures in place, implementation will proceed in a orderly way and completed transactions won't have to be revisited at a later date.

Magnitude of the Problem

Questions continue to arise about whether FIRREA included adequate resources to address the magnitude of thrift losses. Before addressing these questions, let me briefly review the amount of resources that FIRREA actually provided. Let me also stress that these funds are provided to honor the government's commitment to insured depositors, not to bail out the thrift industry.

First, government funds were committed to cover the costs of past FSLIC transactions. While the RTC is currently reviewing ways to reduce these costs, they are currently estimated at a present value of $40 billion.

Second, FIRREA provided the RTC with the amount of $50 billion to pay for the existing problem, that is, net losses associated with thrifts that have failed or will fail from January 1, 1989 until August 9, 1992.

Finally, FIRREA committed up to $32 billion in government funds to the Savings Association Insurance Fund (SAIF) to pay for future problems. Of that $32 billion, $16 billion could become available as soon as October 1, 1992, just about two and one-half years from now.

This commitment of well over $100 billion to address past, present, and future problems demonstrates the efforts of both the Administration and Congress to address this issue squarely. Nevertheless, questions arise about whether the $50 billion provided to the RTC for its slice of the problem will be enough.

The $50 billion provided was based on estimates by the FDIC, the Government Accounting Office, the Federal Home Loan Bank Board, and others of the net cost of resolving the remaining thrifts that were projected to fail at the time FIRREA was introduced. As we said in testimony last October, we do not yet know whether these estimates will prove accurate because of the many variables that continue to exist. These include the pattern of interest rates, the performance of local real estate markets, and the general condition of regional economies.

Moreover, a number of thrifts are unprofitable or fail to meet their capital standards. Some of these could fail in the future. Should they fail after August 1992, net losses will be addressed out of the $32 billion allocated to SAIF by FIRREA for future problems.

However, if some of these fail before August 1992, they would become subject to the RTC's jurisdiction. If the number is small, the cost to the RTC could be modest. If the number is large, the costs would obviously increase--but the offset is that we should then not need as much post-RTC resources for future problems. Some, of course, might never fail at all. The point is that, as we have always said, there are uncertainties in making these estimates, and it is possible that $50 billion will prove inadequate.

The Office of Thrift Supervision (OTS) keeps a Watch List on the thrift industry which it periodically updates. OTS has tentatively updated the Watch List showing institutions "likely to fail" and "distressed institutions." (Distressed institutions, for your information, have been described by OTS as thrifts that are seriously undercapitalized, but that, subject to appropriate caveats for changes in economic conditions or the condition of particular institutions, OTS expects to resolve without government assistance.)

This preliminary information shows that 225-260 institutions with $160-220 billion in assets are in the "likely to fail" category, while an additional 295-325 institutions with $185-205 billion are in the "distressed" category. This Watch List data is being refined by OTS on a continuing basis. We will review this data carefully for its implications concerning the ability to continue the FIRREA program with resources currently provided, because the inclusion of additional thrifts may indicate resolution costs beyond the original estimates.

As you know, the RTC has indicated that the $50 billion presently available will permit it to resolve cases into 1991. However, based on estimates of losses in thrifts currently in conservatorships and its anticipated caseload the RTC has recently suggested that additional funds may become necessary. We are currently examining the data on which these estimates are based.

As this examination process goes forward, we will share with Congress data we believe to be useful and reliable. When we become convinced that it is necessary to either reallocate to earlier periods resources from the $32 billion provided in FIRREA for post 1992 losses, or to provide resources in addition to such reallocation in order to fulfill the government's full faith and credit commitment to insured depositors, we will request appropriate action by Congress in a timely manner.

As we see it, however, the important question at this time is whether the RTC has adequate resources to tackle the immediate problems it confronts. We believe the answer to this question is clearly yes--provided the RTC obtains adequate financing for temporary working capital, as discussed below. Put another way, we do no know what the

RTC, or the Oversight Board, would do differently now if the cost to the RTC were projected to be larger. The focus now should be on moving forward to get the job done.

Expenditure Principles

Because the Oversight Board is acutely aware of the need to husband the resources that Congress has made available, it has adopted a set of expenditure principles to guide the use of funds for purposes other than case resolution. Accordingly, when considering the expenditure of funds for other programs authorized by the statute, the Oversight Board has required that it be provided with a cost estimate of the program and other relevant information. If the program is approved, the RTC is required to monitor the implementation of the program and provide regular reports (including its costs) to the Oversight Board.

Working Capital

As mentioned above, and as contemplated by FIRREA, the RTC will need temporary working capital. In essence, working capital is the temporary use of cash that is raised through borrowings fully supported by assets. The primary purpose of working capital is to permit the RTC to acquire problem assets from a failed institution and carry them until later sale. The borrowed funds used for working capital are supported by the assets acquired, and as the assets are sold the working capital loans are repaid.

This working capital financing is completely distinct from the $50 billion provided under FIRREA to pay for thrift losses. The amounts borrowed for working capital are temporary since they will be repaid by the sale of assets purchased by the RTC; the $50 billion is money that is spent permanently, since it covers the net losses of RTC thrifts after assets are sold and liabilities repaid. Working capital borrowing does not increase the $50 billion in resources available to the RTC to pay for the ultimate cost of the thrift clean-up and every dollar borrowed for working capital is supported with tangible assets to protect the taxpayer from additional exposure.

The benefits of having working capital available in the thrift cleanup are substantial. By separating problem assets from the thrift franchise itself, the RTC can often increase the pool of bidders for both, which can save substantial amounts of money for the taxpayer. Financial institution bidders are interested in acquiring core deposits and quality assets, a "clean" thrift, but may have little interest dealing with problem assets. Other bidders--asset workout specialists, for example--may be interested in acquiring problem assets, but have little interest in core deposits and the thrift franchise. Splitting apart problem assets from core deposits will allow the RTC to sell them separately and appeal to specialized bidders to produce a higher sales price in some cases than would be possible if problem assets were sold as part of thrift institutions in "whole thrift" deals. Working capital financing is necessary to achieve these higher resolution values and to save taxpayers money.

On the other hand, if working capital financing is not provided, the RTC may have to slow case resolutions or hastily sell acquired assets to unlock cash for resolutions. Obviously, neither result is desirable.

A second use of working capital is to temporarily reduce the expensive borrowing costs of thrifts in conservatorships until the time that they are actually resolved by the RTC. To do this the RTC lends cash to a conservatorship at a rate close to the government's borrowing cost, which the conservatorship uses to pay off its high cost funds. This immediate reduction in interest costs reduces the insolvent thrift's operating losses until the thrift is resolved. It also indirectly reduces the cost of funds for healthy institutions that must compete with insolvent thrifts for deposits. Thus, working capital spent to reduce high cost liabilities creates direct savings for the taxpayer.

Finally, working capital may be needed to provide emergency liquidity on a temporary basis to thrifts in conservatorships. These funds are repaid either when the liquidity problems ease or when the insolvent thrift is resolved.

Using working capital for any of these temporary purposes--to acquire assets until they are resold, to provide emergency liquidity, or to reduce high-cost liabilities until insolvent thrifts are resolved--requires substantial amounts of up-front cash. But this cash-intensive process is crucial to the RTC's ability to choose the least cost method of resolving institutions, rather than resorting to a least cash alternative that could cost the taxpayers more money--which is exactly what FSLIC was forced to do in 1988 when it had no cash.

Statutory Limitations on Working Capital

Although amounts borrowed and used for working capital are only temporary, concerns have been expressed that they will be used to increase the $50 billion provided for net thrift losses. These concerns were specifically addressed by Congress in FIRREA. While Congress authorized the RTC to borrow money for working capital, it specifically included an asset-based borrowing cap to protect the taxpayer. This cap limits RTC borrowing to 85 percent of the fair market value of RTC assets, which ensures that tangible assets are adequate to pay off working capital obligations. Working capital borrowing is therefore temporary and self-liquidating through subsequent assets sales.

The final working capital plan will ensure that working capital is accounted for separately from the $50 billion required both to "fill the hole" to pay for net thrift losses and to ensure that the borrowing cap is not exceeded.

The Amount Needed for Working Capital

It is extremely difficult to predict exactly how much working capital will be required over the life of the RTC, although rough estimates by the RTC suggest that such needs peak somewhere between $40 and $100 billion. Variables include, among others: (1) the amount of assets that will actually be acquired by the RTC rather than pass immediately to thrift acquirers as part of case resolutions; (2) the pace of asset sales, which reclaim cash and diminish the need for working capital; (3) the number and size of institutions that the RTC ultimately resolves; (4) the pace at which conservatorships downsize through asset sales before they are resolved; (5) the amount of high cost funds that need to be replaced; and (6) the emergency liquidity needs of conservatorships.

Because of these variables, the RTC will require flexibility to adjust its working capital needs as it works through the process of resolving thrifts. That is why we continue to support the decision in FIRREA to impose an asset-based borrowing cap rather than fix a specific amount as the cap. It is simply too difficult to fix a ceiling with any certainty, and a cap that is too low would seriously constrain the RTC's ability to resolve cases as quickly as possible. This would raise the cost to the taxpayer.

How soon will the RTC need working capital? As you know, the timetable for the RTC's need to have working capital has accelerated from estimates made last fall. Earlier this month, the RTC and the Oversight Board advised Congress that plans for working capital are expected to be finalized by mid-February, and working capital would begin to be provided shortly thereafter. Estimates indicate that between $27 and $44 billion will be needed during calendar year 1990 depending upon the number of thrifts placed in conservatorship and the pace of asset sales out of receivership. It should be noted that this 1990 estimate does not include potential financing for high cost funds replacement. Both agencies stated that, given the resources currently available to the RTC, including proceeds from a second REFCORP issue last week, and on the basis that the practical and legal issue described below with respect to each approach are resolved in a satisfactory manner, the RTC and the Oversight Board expect the resolution program to proceed without interruption.

Prior to last week's REFCORP issue, the RTC has been provided $24.5 billion. Why might it need working capital in the near future? As mentioned above, the funds specifically provided under FIRREA through appropriations and the Resolutions Funding Corporation--the $50 billion--is to be used to pay for the net losses associated with case resolutions. The RTC has spent $22 billion thus far, of which approximately $15.6 billion has been spent for temporary working capital purposes and which will be returned to the RTC when the working capital facility is in place:

- $5.4 billion for the temporary acquisition of assets;
- $8.3 billion for the temporary reduction of borrowing costs for thrift conservatorships; and
- $1.9 billion for emergency liquidity needs.

In other words, based on preliminary RTC estimates, of the $22 billion spent so far, only approximately $6.4 billion has been permanently spent to "fill the hole" to pay for net losses in thrift resolutions, and only this amount should really be counted as coming from FIRREA's $50 billion. The actual loss on these transactions is subject to evolving market conditions. (See Chart 1.)

In short, the RTC has been using these permanent loss funds for working capital purposes pending the final plans for a working capital facility. These funds have certainly been adequate for the RTC to move forward, with $2.4 billion remaining to be spent and another $5 billion expected to be raised by REFCORP by the end of January. Nevertheless, it is clear that the RTC cannot continue with these funds to finance its working capital need indefinitely.

The Oversight Board and the RTC have undertaken to resolve working capital plans by the middle of next month and begin providing temporary working capital to the RTC shortly thereafter. At that time, the working capital raised will also be used to replace the permanent loss funds that have been temporarily devoted to purposes that working capital funds will cover in the future. As the Oversight Board and the RTC stated in their letter to Congress, this schedule will not interrupt the RTC's case resolution program.

CHART 1

RTC'S SOURCES AND USES OF FUNDS

As of January 12, 1990
($ BILLIONS)

USES		
O NET THRIFT LOSSES		$ 6.4 E
O THE WORKING CAPITAL EXPENDITURES:		
MARKET VALUE OF ASSETS PURCHASED IN CASE RESOLUTIONS	$5.4 E	
HIGH COST FUNDS REPLACEMENT	8.3	
LIQUIDITY ADVANCES	1.9	
TOTAL WORKING CAPITAL		$15.6 E
O STILL AVAILABLE FOR CASE RESOLUTIONS		2.5
TOTAL		$24.5
SOURCES		
O FEDERAL HOME LOAN BANK RETAINED EARNINGS		$ 1.2
O APPROPRIATED FUNDS		18.8
O REFCORP BOND ISSUES		4.5
TOTAL		$24.5

E = ESTIMATED

Let us now turn to a description of the three approaches that we are currently considering for financing working capital needs, whether alone or in combination. These approaches have emerged after considering a range of options.

Borrowing from the Federal Financing Bank

One approach is for the RTC to borrow working capital directly from the Federal Financing Bank (FFB), which is a federal instrumentality subject to Treasury supervision. The FFB lends low-cost funds to federal agencies as a substitute for direct agency borrowing in the market. This approach has the benefit of flexibility, as well as having cost advantages.

However, in light of the importance of the working capital issue and the magnitude of borrowing contemplated we must be assured a sound legal basis exists for this approach. Thus, legal questions about the authority of the FFB to lend to the RTC must be resolved. These include issues relating to whether the RTC falls within the scope of entities authorized to borrow from the FFB and whether the borrowing contemplated under this approach is of the type in which the FFB can engage. Treasury's General Counsel is working with the Justice Department's Office of Legal Counsel to resolve these issues.

Borrowing from the Federal Home Loan Banks

A second approach is for insolvent thrifts in RTC conservatorships to borrow directly from the Federal Home Loan Banks at a negotiated spread over the Banks' consolidated borrowing costs. This approach would be used only to the extent that the rate charged by the Banks is significantly lower than the rates that insolvent thrifts currently pay in order to attract high-cost brokered deposits. We expect that this borrowing would require some form of credit enhancement, such as an RTC guarantee or letter of credit.

The costs of borrowing from the Federal Home Loan Banks would be slightly greater than the costs of borrowing from the Federal Financing Bank. But they would be considerably lower than the current cost of borrowing through expensive brokered deposits. Moreover, any spread above FFB borrowing would remain with the thrift industry rather than pass to outside investors. FHL Bank profits on the loans would be passed on to thrift shareholders as dividends or reduced borrowing costs. These additional earnings could help marginal thrifts to survive and reduce the losses of thrifts headed toward conservatorships.

Oversight Board staff have had preliminary discussions with representatives of the FHL Banks, who appear interested in studying the issue further. There are, however, legal and practical questions that remain to be resolved concerning the appropriate form of credit enhancement. In addition, there are practical limitations to the amount of potential borrowing from the FHL Banks. In particular, the Banks' capital requirements will constrain the total amount of new lending that could be provided. One current estimate is that the maximum amount available would be $15 billion this year. While this is not likely to satisfy all of the RTC's working capital requirements, it could certainly contribute substantially to overall needs.

Low-Cost Institutional Deposits
A third approach is to design a mechanism to lower the cost of retail brokered deposits that are currently issued by insolvent thrifts in RTC conservatorships. This would only be used to reduce borrowing costs pending case resolutions, and, as with borrowing from the FHL Banks, only if it would substantially lower these borrowing costs. Given the volume of high-cost brokered deposits, the idea is to explore ways of packaging these deposits and selling them in large amounts to large institutional investors.

These investors typically do not invest in the relatively small retail units of $100,000 necessary to maintain federal insurance on deposits. But they could be interested in large blocks of these full faith and credit investments with only a narrow spread offered above comparable investment vehicles, such as Treasury obligations. Marketing and distribution costs would also be reduced by avoiding the costs associated with placing deposits through extensive retail networks.

This approach is only at a preliminary stage. We have had initial discussions with industry representatives concerning its feasibility. Questions remain about the volume that would actually be absorbed by the market given alternative investments available. A potential roadblock is the practice of permitting acquiring institutions in thrift resolutions to reduce the interest paid on deposits immediately following an acquisition. This creates uncertainty about the ability of investors to lock in rates until maturity, which in turn increases borrowing costs. While these issues must be resolved if this option is to be practically feasible, we believe the approach merits further examination.

As stated above, we expect to finalize our plans by mid-February, after the policy, legal and practical issues are resolved, and begin providing working capital to the RTC shortly thereafter. However, no working capital obligations will be issued by the RTC until we have fully briefed the Congress on our plans. This schedule will not interrupt the RTC's case resolution program.

Budget Treatment

After finalization and adoption of the working capital approach, the determination of the treatment of working capital borrowing for budget purposes will be made by the Administration in consultation with Congress. The President's budget for fiscal year 1991, which was released on Monday, discusses this issue, reviews the characteristics of RTC working capital, and commits to work with Congress to devise an appropriate approach.

Appointments

Currently, candidates for the two public members of the Oversight Board are in the Presidential selection or clearance process and candidates for the chairpersons of the National and Advisory Boards are entering the clearance process. In order to identify qualified individuals, the recruitment process has taken time. We keenly appreciate the desirability of getting the appointees in place and expect to have this accomplished in the near future.

Strategic Plan Development

One of the essential tasks undertaken by the Oversight Board has been the preparation of a strategic plan for the RTC. The strategic plan establishes policies, goals, and objectives for a broad range of the RTC's operations. I will describe the strategic plan developed by the Oversight Board in some detail.

The strategic plan was developed by Oversight Board staff in consultation with staff of the Treasury Department, the Department of Housing and Urban Development, the Federal Reserve Board, and the RTC. The cooperation among the agencies has been excellent, and I would like to take this opportunity to thank the many people who contributed to the strategic plan for their efforts.

The strategic plan includes both general policy and goals, objectives, and implementing procedures. The strategic plan's goals establish direction for RTC in six areas: case resolution, asset disposition, affordable housing, conflicts of interest and ethical standards, external relations, and administration. The strategic plan's objectives provide more specific direction with respect to each goal. Consistent with FIRREA's concept that the RTC is the operating entity, the strategic plan generally relies on the RTC to develop the detailed implementing procedures to carry out the strategic plan's goals and objectives. The plan includes the guidelines and procedures to be provided by the RTC to the Oversight Board by certain dates.

To ensure public participation in plan development, the Oversight Board decided to publish a proposed strategic plan for public comment, even though it was not required to do so by Congress. The Board believed that the plan could benefit from scrutiny by the diverse array organizations and individuals who will be affected by and involved in its implementation.

By the time the final draft of the strategic plan was prepared, responses had been received from 85 individuals and organizations. These comments were considered in preparing the final strategic plan.

The Oversight Board regards the strategic plan as a living document. As the Board and the RTC develop more experience, issues will arise that will require new policies and directions. As a result, the Board expects to update and refine the strategic plan on a periodic basis.

A. CASE RESOLUTION

Management of Institutions in Conservatorship

The RTC is responsible for the prudent operation of its caseload of institutions in conservatorship. Under the strategic plan, the RTC is to manage thrifts in conservatorship in a manner that reduces the RTC's risk exposure, reduces operating losses, pays down high-rate liabilities, and in general, prepares them for eventual sale and liquidation.

To the extent feasible and cost effective, the asset side of the balance sheet should be reduced through the packaging or securitization and sale of financial assets. By March 30, 1990, the RTC will establish a national sales program to coordinate the disposition of these financial assets, making full use of the secondary mortgage market agencies. Oversight Board staff have been meeting with staff from the Federal National Mortgage Association (FNMA) and the Federal Home Local Mortgage Corporation (FHLMC) to examine asset securitization and programs, and RTC staff in the Atlanta regional office are exploring the possibility of setting up a pilot program to securitize and sell mortgage-related assets.

Thrifts with significant franchise value (i.e., desirable core deposits that can be sold at a meaningful premium) should be permitted to maintain their asset levels.

However, any new lending or investments should be limited to low-risk assets as defined in FIRREA for institutions failing to meet their minimum capital requirements.

Thrifts without significant franchise value should have their balance sheets shrunk in a coordinated and orderly manner. Generally, loan originations should cease, and the cash flow from payments of principal and interest should be used to repay high-cost insured deposits and other secured borrowings--with two exceptions. First, additional lending should be permitted if it would reduce losses on existing assets or occurs as part of a planned resolution. Second, consistent with minimizing the cost of resolution, minority-owned institutions in conservatorship should not be abolished through overly aggressive downsizing.

Resolution Prioritization Schedule

A prioritization schedule is clearly needed because the RTC is responsible for many thrifts and cannot resolve them all simultaneously. The strategic plan asks the RTC to prioritize institutions for resolution at a minimum by quartiles. In doing so, the Oversight Board stated its view that the most important factor to consider is the rate of deterioration in net worth of an institution. This provides a measure of the cost savings that the RTC could achieve by resolving an institution quickly. Deterioration includes both ongoing operating losses and loss of franchise value due to eroding customer bases and the loss of key personnel. As such, institutions with the highest operating losses (both in absolute terms and relative to the expected cost of resolution) and the greatest erosion in franchise value should be given first priority.

Other factors to be considered are the ongoing risk exposure to the RTC--for example, from institutions with large interest rate or credit risk exposure--and the efficient use of RTC resources and staff.

The RTC has drafted written guidelines and procedures for prioritizing thrifts for resolution and a prioritization schedule. Using various numerical indicators of the rate of deterioration, franchise value, and level of investor interest, the RTC developed six prioritization schedules, with institutions ranked in quartiles. One schedule prioritizes all institutions under RTC's jurisdiction in the country, another priorities institutions with $500 million or more in assets, and the other four schedules, one for each of the RTC's four regional offices, prioritize institutions with under $500 million in assets in each region. These schedules will be updated quarterly.

Method of Resolution

Case resolutions generally take the form of either liquidations or assisted acquisitions. Assisted acquisitions may take the form of "whole thrift" transactions in which all of the liabilities are assumed and almost all of the assets of an institution are acquired by an acquirer, or "clean thrift" transactions in which the bulk of the liabilities, but only performing assets are purchased by an acquirer, with stripped liabilities and assets acquired by the RTC for disposition. In either case, the RTC provides the acquirer with cash to make up for the shortfall between the value of the liabilities assumed compared to the market value of the assets acquired.

In selecting a method of resolution, FIRREA prohibits the RTC from providing assistance in an amount (including reasonably ascertainable foregone federal tax revenues) in excess of that required to liquidate an institution, unless the RTC determines that the continued operation of the institution is essential to provide adequate banking services in its community. Pursuant to the strategic plan, the RTC has developed a methodology for estimating the cost to liquidate thrifts under its jurisdiction as a basis for deciding whether to do an assisted acquisition.

FIRREA also requires that the RTC conduct its operations in a manner which maximizes the net present value return from the sale or the disposition of institutions or their assets and minimizes the amount of any loss realized in the resolution of cases. Pursuant to the strategic plan, the RTC has developed written guidelines for the loss minimization criteria in FIRREA.

The strategic plan encourages competition among bidders to determine the method for resolving a particular institution. The Oversight Board believes that potential acquirers should be allowed to bid on a variety of resolution structures (e.g., whole thrift, clean thrift, branch sales), and the RTC should select the least-cost solution based on the bids received. In a recent transaction in Kansas, the RTC failed to receive bids on a whole-thrift or clean-thrift basis which exceeded the cost of liquidation, but when it invited bids on insured deposit transfers on a branch-by-branch basis, it received $6 million in premiums over the cost of liquidation, suggesting that allowing flexibility in regard to resolution structure may save the taxpayer money.

Financial Assistance for Case Resolution

Financial assistance for case resolution will generally take the form of cash equal to the difference between the value of the liabilities assumed by the acquirer (e.g., deposits) and the value of the assets acquired by the acquirer (minus any purchase premium).

In addition, the RTC may provide financial assistance involving a financial contingency (asset puts, asset guarantees, or capital loss coverage). In general, such financial assistance should not exceed a period of six months or the time required to complete due diligence. Such assistance gives the acquirer the opportunity to complete its due diligence assessment of the quality of acquired assets, thereby reducing the risk premium that an acquirer would otherwise charge. As you know, the Oversight Board's six-month rule stands in sharp contrast to the five- and 10-year financial arrangements entered into by the FSLIC prior to the enactment of FIRREA, and responds directly to the concern expressed by many Members of Congress about those transactions. The Oversight Board believes that the six-month rule generally operates to reduce the total cost to the taxpayer while circumscribing the duration of the RTC's contingent liability for these assets.

Having said that, I want to make you aware that the RTC recently has asked the Oversight Board for clarification as to the degree of flexibility available to it under the six-month rule, particularly in cases in which the quality of assets and record-keeping is so poor as to make due diligence difficult to accomplish within a six-month timeframe. The Oversight Board believes that the RTC's request is reasonable and is actively considering it. This action exemplifies the Oversight Board's view that the strategic plan is a living document, and that policies will necessarily be refined as additional experience is gained.

With regard to thrift resolutions, the strategic plan asks the RTC to avoid taking equity interests that permit the RTC to exercise control or actively participate in the management of resolved institutions. However, the RTC may take passive equity positions, through the use of warrants or other devices, in order to permit the RTC to share in any substantial gains by resolved institutions.

The strategic plan calls for the RTC to develop guidelines for the use of permitted forms of financial assistance by January 31, 1990.

Bidding Procedures

The Oversight Board believes that a significant way to reduce the cost of resolutions is to encourage active participation in the resolution process by all qualified bidders, even though increasing the number of bidders may slow the pace of resolution. The strategic plan instructs the RTC to develop an open and widely publicized bidding procedure, to broadly disseminate information regarding institutions being marketed, and to disclose the terms of previous transactions. The strategic plan also encourages the active participation of women and minorities.

The Oversight Board has instructed the RTC to publicize the procedures that bidders must follow to bid on institutions. Consistent with the strategic plan, the RTC has developed written plans for soliciting bids from potential buyers without preference to type of organization, including procedures for encouraging active participation in the bidding process by women and minorities; for giving bidders access to full information including financial statements, deposit levels, and organization structures on each institution that they are considering; for making available to all potential bidders the terms of previous transactions; for evaluating and selecting among offers in a timely and nondiscriminatory manner; and for notifying rejected bidders within 30 days.

In addition, the Board also asks the RTC, to the extent practicable and efficient, to use private sector entities for the management and disposition of institutions under RTC jurisdiction, and the RTC has identified areas where they could do so.

To facilitate participation by all types of bidders, bidders should have at least four weeks to file necessary applications and for the chartering, regulatory and insurance agencies to process and evaluate applications.

Resolution of Minority Thrift Institutions

Let me say a word about minority-owned thrifts in conservatorship. The Oversight Board would like these thrifts to continue as minority-owned institutions and looked for a way to facilitate their continuation as minority institutions that was consistent with its expenditure principles.

Accordingly, the strategic plan provides that the RTC may assist a qualified minority acquirer by postponing for up to nine months the closing of a transaction until the acquirer finds permanent capital or by providing up to nine months of bridge financing on up to two-thirds of the required capital for the acquired institution. The financing is to be provided at market rates and secured by the capital placed in the institution by the acquirer. After considering RTC estimates of the potential expenditures involved, the Oversight Board decided that the amount of such RTC financing that can be provided under this program should not exceed $32 million. The initial equity investment of the acquirer would be at risk in the event the acquirer were unsuccessful in raising the required capital within the nine-month time period.

This policy complements the Oversight Board's policy, described above, to protect minority institutions in conservatorship from overly aggressive downsizing.

Open Thrift Assistance

While Congress has not mandated that the RTC provide open thrift assistance, under FIRREA, the FDIC has the discretion to provide open thrift assistance through the Savings Association Insurance Fund (SAIF) under certain limited circumstances. At this time, however, SAIF has no funds available for this type of assistance. Under FIRREA, the FDIC may request that the Oversight Board direct the RTC to provide SAIF with the necessary funds.

The Oversight Board has strong reservations about diverting financial resources from the RTC to fund open thrift assistance. Therefore, the Oversight Board approaches this matter cautiously and will consider providing these resources if SAIF and RTC request it to do so, but only after the Board has first evaluated the past success of the FDIC in the use of this type of assistance, and prepared estimates of the level of RTC resources that might be needed.

Review of 1988-1989 FSLIC Deals

Under FIRREA, the RTC is responsible for reviewing and, if cost effective, restructuring the case resolutions entered into by FSLIC between January 1, 1988, and August 9, 1989. The review will cover 96 agreements providing for the acquisition of 199 thrift institutions with $110 billion in assets. It will also cover whether the bidding process for the transactions was sufficiently competitive. The strategic plan calls for the RTC to complete this review as expeditiously as possible and to make its final report to the Oversight Board and the Congress no later than August 31, 1990.

Status of the Liquidation of FADA

The RTC has indicated that FADA will be liquidated as of February 9, 1990, as required by FIRREA. The RTC was unsuccessful in its attempt to sell FADA as an entity, including its assets, network of offices, computer systems and office furnishings. Three bids were received among 400 solicited, all of which were judged unacceptable. The RTC announced in mid-November that it would dissolve the agency.

Of FADA's 250 employees, approximately 190 were offered positions with the FDIC, of which 140 have accepted. The

FDIC's liquidation division now manages the assets that had been FADA's responsibility and continues to evaluate bids for the purchase of assets.

B. ASSET DISPOSITION

Magnitude of the Program

Assets not sold as a part of a thrift resolution will have to be disposed of separately by the RTC. The volume of assets that the RTC will dispose of will depend in part on the methods used to resolve thrifts. Assets for disposition will fall into one of three categories: (1) cash and readily marketable loans, servicing rights, and securities; (2) high risk but performing loans; or (3) real estate owned and non-performing loans, including loans in foreclosure.

Approximately one-half of the assets managed by the RTC in conservatorships and receiverships are currently comprised of single-family mortgages, mortgage-backed securities and other liquid assets. As noted above, conservators are instructed to reduce the assets of institutions held in conservatorship. Because the books and records of many thrifts taken into conservatorship or receivership deteriorated as insolvency approached and employees left, the RTC must reconstruct many loan files and other records before a number of these assets may be marketed. Assets such as delinquent commercial real estate loans will require the skills of workout specialists to assure that the RTC is disposing of properly secured loans free of lender liability, environmental and similar uncertain claims. Hardest to dispose of will be the real estate assets, where the risks posed by various claims will be compounded by the need to assure clean title to prospective purchasers. The strategic plan contemplates that the RTC will rely heavily on private sector contractors in moving promptly to resolve these types of problems.

Consistent with the strategic plan, RTC has developed the necessary guidelines and procedures to proceed actively to dispose of assets immediately in a manner consistent with FIRREA.

RTC's Real Estate Property Inventory

The RTC's first asset inventory, published on December 31, 1989, listed over 30,000 real estate assets that the RTC was managing on September 30, 1989. It included approximately 21,500 one-to-four-unit residential properties (including about 400 mobile homes and 6,500 condominiums), 1,500 multi-family residential properties, 2,500 commercial properties, and 800 parcels of undeveloped land. A separate volume listed over 600 single-family and 55 multi-family properties that will be marketed under the affordable housing provisions of FIRREA. While these assets are distributed among all four RTC regions, the bulk of them is located in the Southwest.

Each asset listing includes the name and location of the asset, a brief description, and the name of a person or organization to contact for more information about the asset. The description for most assets also includes a listing price. Telephone numbers for RTC agents or other authorized contacts are also included. This list will be updated at least semiannually.

Rate of Asset Disposition

It is the Oversight Board's policy that the RTC should proceed with the prompt and orderly disposition of assets and avoid holding properties (except to comply with the affordable housing right-of-first-refusal marketing provisions in FIRREA). Holding properties off the market for an extended period of time will generally not serve the interests of either the local community or the taxpayer. The uncertainty caused by an overhang of properties held off the market may depress local property values more than would their sale. The RTC should not attempt to "outguess the market" by speculating on future developments not reflected in the current market values of properties.

The ongoing resolution of insolvent thrift institutions during the next several years, together with delays inherent in securing title to properties that come under the RTC's control by means of foreclosures, workouts and the like, will result in the disposition of the RTC's assets over a multi-year period, even if individual properties are marketed expeditiously.

The RTC will be a significant holder of real estate in some markets already beset by economic problems and experiencing declining real estate values. Special asset disposition procedures are required to protect against the dumping of assets while not restricting the flexibility that the RTC needs to make sound business decisions. The RTC has already begun consulting with other federal agencies that are selling assets in the same markets to minimize the adverse effect of its transactions in distressed areas and to preserve the availability and affordability of housing for low- and moderate-income households.

Use of the Private Sector

The sheer number of assets to be worked out will require that the RTC rely heavily on private sector contractors for the management and disposition of these assets, subject to general oversight and audit by the RTC. The private sector must also play a leading role in organizing the loan documentation and records necessary to market mortgages, mortgage-backed securities and mortgage servicing rights. In many cases, these assets can only be sold into the capital markets if the related loan and document files are restored to a state that will permit prospective purchasers and servicers to satisfy minimum continuing due diligence thresholds. Sales of specialized assets such as high-yield bonds may require the assistance of experts experienced in the distribution of financial instruments for which only a thin market exists and detailed knowledge of the issuer is a predicate to a sale for adequate value.

Efforts to downsize institutions in conservatorship (281 as of December 31, 1989) through sales of assets resulted in a 14 percent reduction in assets through November 30, 1989, all of which are now in private sector hands. In addition, all of the assets that the RTC currently holds in its receiverships ($7.9 billion book value) are serviced by the private sector through short-term servicing contracts generally between the RTC and the acquiring organizations. These contracts generally provide for no more than reimbursement of the acquirer's out-of-pocket expenses.

The RTC anticipates moving the management of additional assets to private sector contractors and has taken a number of steps to prepare for the use of private sector contractors on a widespread basis.

- First, the RTC has mailed over 3,500 information packets to potential contractors, the purpose of which is to pre-qualify potential contractors for purposes of bidding on RTC contracts. The RTC expects to send out an additional 4,500 packets over the next several weeks.
- Second, the RTC has developed three sets of interim procedures relating to clarification and assignment of assets to types of contractors, qualification and selection of contractors, and incentive arrangements in contracts.
- Third, the RTC has issued its proposed rules regarding conflict of interest and ethical standards for independent contractors and expects to issue final rules in the near future.

Taken together, these policies and procedures will provide a comprehensive framework for utilization of private sector contractors on a broad scale.

The strategic plan calls for the RTC to establish annual targets for utilization of the private sector and to report on its performance using a variety of measures. The strategic plan also calls for the RTC to use a variety of incentive contracts as a means of assuring that the government receives the maximum net present value return on its assets.

Minority and Women Out-Reach Program

As required by FIRREA, to assure that the RTC employs the services of minority and women firms, the strategic plan asks the RTC to create a minority and women outreach program by January 31, 1990. This program should, at a minimum, include: a definition of what constitutes an eligible individual firm; a process for identifying and certifying eligible minority and women contractors (including firms owned by minorities and women); active promotion of an outreach program to eligible individuals and firms; and the development of an ongoing monitoring mechanism to allow evaluation of the RTC's performance under the outreach program.

To facilitate the success of the outreach program, the RTC's evaluation criteria for selecting among qualified potential contractor should include a factor that reflects whether the potential contractor is an eligible entity (or a firm contracting with an eligible entity).

As requested by the Oversight Board in accordance with its expenditure principles, the RTC estimated that allowing minority and women contractors a price advantage of up to three percent on work done for the RTC would cost approximately $2 million per annum. Accordingly, the Oversight Board authorized an expenditure by the RTC of up to $2 million per annum and $6 million in total for this program.

Bulk Sales

The strategic plan permits the RTC to use bulk contracts for asset management and disposition if the RTC deems that they will maximize the net present value of the proceeds. Given the large number of assets involved, the RTC may determine that it is efficient to dispose of assets in large, wholesale transactions. The RTC should experiment with alternative methods of structuring bulk transactions.

Seller Financing

The strategic plan asks the RTC to provide financing of asset sales sparingly. The plan states that any financing provided by the RTC in asset sales (with the exception of assets eligible for the affordable housing program, which will be addressed separately) should be subject to the following restrictions: only real estate should be eligible for RTC financing; the buyer of the asset should make a significant equity contribution (i.e., at least 25 percent) and pledge the asset as collateral; RTC-provided financing should be senior to those of other creditors; concessionary terms on the financing should be minimized and always recouped through a higher sales price; all loans made by the RTC (other than short-term bridge loans) should be sold to the maximum extent feasible; and performance guarantees on loans sold by the RTC should not exceed six months in duration.

Here, too, the RTC has asked the Oversight Board to revisit a policy. The RTC would like more flexibility in the use of seller financing and has proposed some refinements to the existing policy. The Oversight Board is studying their proposal and expects to grant additional flexibility within some specified limits in the near future.

C. AFFORDABLE HOUSING

FIRREA requires that eligible affordable housing properties first be offered to qualified purchasers for 90 days through clearinghouses administered by state housing finance agencies, the Office of Community Investment or other division of the Federal Housing Finance Board (FHFB), and certain national nonprofit organizations. This 90-day "right-of-first-refusal" period entails holding costs which are to be borne by the RTC.

The strategic plan provides that, no later than March 30, 1990, the RTC should develop guidelines and procedures that implement the low- and moderate-income provisions of FIRREA and maximize the effectiveness of this right-of-first-refusal period.

Interim Marketing Period

Before March 30, 1990, to avoid keeping needed housing off the market and to avoid deterioration of the eligible properties while comprehensive guidelines are being developed, the RTC may sell eligible properties after developing interim guidelines for review by the Oversight Board. These guidelines, which have now been submitted to the Oversight Board for review, may authorize pilot projects that test various program concepts, but do not provide direct subsidies. The strategic plan requests the RTC to report to the Oversight Board on the results of its interim marketing efforts by May 30, 1990.

Consultation with Other Agencies

Under FIRREA, many federal agencies are directed to assist the RTC's eligible property marketing effort by expediting the processing of applications for assistance under a number of specified programs, including FHA mortgage insurance. In an effort to coordinate their efforts and to increase the effectiveness of the affordable housing program, the RTC is consulting with these agencies as well as State and local and private sector agencies that can financially assist qualified households and organizations in purchasing owner-occupied and rental housing. These organizations include the federally sponsored secondary mortgage market agencies and state and local housing finance agencies.

In addition, the RTC and Oversight Board staff have been cooperating with FHFB staff on use of the Community Investment Program and the new Affordable Housing Program authorized by FIRREA in support of the RTC's affordable housing marketing effort.

Clearinghouses

The RTC has already contacted the governor of each state requesting designation of the state's housing finance agency as a clearinghouse. Criteria are also being developed for designation of national nonprofit organizations as clearinghouses.

Disposition of Eligible Properties

FIRREA directs the RTC to determine a market value for each eligible residential property and sell eligible properties at the net realizable market value. The net realizable market value is the price below the market value that takes into account any reduction in certain holding and transactions costs resulting from expedited and direct sale of a property.

The RTC should consider selling eligible properties in bulk to capable nonprofit organizations and state and local housing agencies. The reduction in transaction costs to the RTC resulting from a bulk sale may permit the RTC to sell properties at a below-market price and still maximize net present value.

Competing Bids

When selling single-family properties, the RTC may have to choose between substantially similar competing offers from low- and moderate-income households. In the case of multi-family housing, FIRREA directs the RTC to give preference to offers that propose to house more very low-income and lower-income families. The strategic plan also calls for the RTC to establish guidelines for competing offers for single-family purposes.

Price Discounts and Concessionary Financing

While the strategic plan does not at this time permit the use of direct subsidies by the RTC for the marketing of eligible properties, the Oversight Board will carefully monitor the RTC's marketing efforts to determine the degree to which FIRREA's affordable housing objectives are being achieved. If the Board determines that the mandatory right-of-first-refusal period is not meeting the housing objectives of FIRREA, then the Board will determine if direct subsidies are necessary to meet such objectives; the appropriate form of the subsidies; and the total amount of subsidy, if required.

D. CONFLICTS OF INTEREST AND UNDUE POLITICAL INFLUENCE

Conflicts of Interest

Under FIRREA, the Oversight Board and the RTC must promulgate rules and regulations that are: (1) applicable to independent contractors governing conflicts of interest, ethical responsibilities, and the use of confidential information; and (2) applicable to members, officers, and employees of the Oversight Board and the RTC governing conflict of interest, ethical responsibilities, and post-employment restrictions.

In early October 1989, the RTC issued an interim statement of principles of ethical conduct for independent contractors. Subsequently, on November 28, 1989, the Oversight Board and the RTC published a proposed rule for public comment that would establish minimum qualifications, ethical standards of conduct, and restrictions on the use of confidential information for independent contractors who seek or contract to provide services for the RTC. It is the intention of the Board and the RTC that a rule be formulated that preserves the integrity of the system and also assures the private sector's participation to the maximum extent feasible. Comments on the proposed rule were due by January 12, 1990, and are being reviewed by staff preparing the final rule.

Under FIRREA, the Oversight Board and the RTC must issue regulations on conflicts of interest, ethical responsibilities, and post employment restrictions, applicable to their employees, that are no less stringent than the employee conduct regulations of the FDIC. By early January 1990, both the RTC and the Oversight Board published proposed rules for comment. Pending issuance of final rules, the FDIC's standards of conduct regulations apply to employees of RTC and the Oversight Board, except for employees detailed from other agencies, who are subject to the rules of such agencies.

Political Favoritism

FIRREA also requires that measures be taken to avoid political favoritism and undue influence in contracts and decisions made by the Oversight Board and the RTC. The RTC is requested to develop specific written guidelines and procedures by March 30, 1990 concerning the avoidance of political favoritism and undue influence upon contracting and decision making, drawing upon current FDIC policies, but with specific focus upon the situation of the RTC.

Also, in the interim, all communications initiated by senior public officials (or their staff) with employees conducting the work of the RTC that are intended to influence a case specific decision currently before the RTC, shall be logged and the records of such communications should be made available for public inspection.

E. EXTERNAL RELATIONS

As a new instrumentality of the U.S., it is critical for the RTC to establish and maintain good relationships and open communications with other entities. The RTC must be responsive to Congressional inquiries and cooperate with other government offices. The nature of the mission of the RTC also makes imperative a positive relationship with the public.

Communications with Advisory Boards and the Public

The National and Regional Advisory Boards are being established by the Oversight Board to provide an avenue for communications with the public regarding the RTC's guidelines and procedures for the sale or disposition of real property assets. The National and Regional Advisory Boards will bring local expertise and concerns to the attention of the RTC and the Oversight Board and will provide a means for the RTC and Oversight Board to improve public understanding regarding the RTC's activities. The Board expects the advisory boards to be functioning by the spring of 1990.

Questions or concerns may be raised by the public through other channels. By March 30, 1990, the RTC should develop mechanisms to monitor and respond to general complaints and complaints of discrimination on the basis of race, sex or ethnic group in the solicitation and consideration of offers.

F. ADMINISTRATION

In its oversight capacity, the Board must periodically review the overall performance of the RTC including its work, management activities, internal controls, and performance relative to its approved budget plans. The strategic plan sets forth objectives and strategies to assure that the RTC has sufficient and effectively managed resources to achieve its mission.

Planning and Budgeting

The plan asks the RTC to present an annual operating plan and budget to the Oversight Board for approval for each upcoming calendar year. The RTC should also provide the Board with a staffing plan, including planned employee levels for the upcoming year and a current organizational chart.

The RTC submits to the Oversight Board, on at least a quarterly basis, financing requests that describe its projected use of funds over succeeding weeks and request a general authorization to spend the projected amount. After Board staff review, its recommendation and the RTC's request are submitted to the Oversight Board for a general authorization to spend all or part of the requested funds.

Compliance with Environmental Laws

In order to address environmental concerns, the RTC is operating under current FDIC policies regarding compliance with the National Environmental Policy Act, the Endangered Species Act, the Council on Environmental Quality, and executive orders regarding floodplains and wetlands.

In keeping with FIRREA, the RTC developed criteria with the assistance of several government agencies for identifying properties having natural, cultural, recreational, or scientific values of special significance. A variety of properties are so identified in the Real Estate Asset Inventory that the RTC released on December 31, 1989, and as additional properties are identified for inclusion in these categories, the RTC will move promptly to add them to the list.

Reporting Requirements

FIRREA authorizes the Oversight Board to require from the RTC any reports, documents, and records it deems necessary to carry out its oversight responsibilities. Furthermore, FIRREA imposes reporting requirements on the RTC, including reports to Congress. The RTC, in consultation with the Oversight Board and Congress, will work to streamline the process for responding to the various reporting requirements imposed on the RTC by Congress, the Oversight Board, and others.

The strategic plan requires the RTC to appraise its operations, including cooperating fully in audits such as those performed by the Inspector General, Comptroller General, and Oversight Board to assist its Board of Directors and management in ensuring an efficient, economical, and effective application of its resources.

Internal Controls

The RTC must maintain strong internal controls and an accounting system in view of the large amount of assets and funds involved. The RTC should take all appropriate steps to facilitate periodic on-site reviews and general evaluations of these controls and systems by the Oversight Board as it fulfills its oversight duties.

The **Chairman**. We have a number of questions, but I want to first ask Chairman Greenspan if he would like to make any additional comments or observations, and then Secretary Kemp, before we begin the questioning.

STATEMENT OF ALAN GREENSPAN, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION; CHAIRMAN, BOARD OF GOVERNORS OF THE U.S. FEDERAL RESERVE SYSTEM, WASHINGTON, DC

Mr. **Greenspan**. Thank you very much, Mr. Chairman.

I have no additional comments.

The **Chairman**. Secretary Kemp.

STATEMENT OF JACK KEMP, MEMBER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION; SECRETARY, U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, WASHINGTON, DC

Mr. **Kemp**. Mr. Chairman, John Robson has covered the highlights of the final strategic plan.

I wonder if it might be appropriate, I would be happy to wait until the subject of affordable housing is further elaborated upon by members of the committee in their questioning; but I would be happy to touch briefly on it at this time, or wait for the questions. It would be up to you, Mr. Chairman.

There is a statement, though, that I would like to make, to give an assurance to you, Mr. Chairman, and to the committee that we at HUD, and working with my colleagues on the Oversight Board of RTC, take very seriously the mission that has been given to us by the Congress.

The **Chairman**. I am inclined to agree with Senator Sarbanes, and that is that I think that is an important policy question. I think we ought to have it clear on the record, up-front, that you have a view on it. I think we should hear it now.

Mr. **Kemp**. Well, let me say, Mr. Chairman, as pointed out earlier——

The **Chairman**. Will you be expressing the view now of the Oversight Board in total, or will you be expressing——

Mr. **Kemp**. I will be speaking as to my responsibilities at HUD and serving on the RTC Oversight Board, to the specific mandate given to the Board with regard to affordable housing. And as I said, I would be happy to wait for your questions, or make a brief statement for the record.

The **Chairman**. No, let's hear it now.

Mr. **Kemp**. And I will paraphrase it to the best of my ability, but I would like to include it for the record, as I did for Chairman Gonzalez on the House side.

The **Chairman**. Very good. We will take the longer statement for the record, but we would like your comment now.

Mr. **Kemp**. Let me just say briefly, Mr. Chairman, that while the strategic plan did not go as far as some might have hoped, I believe sincerely that we did lay the groundwork for further progress, and for meeting the challenge and the mission that has been provided to us, not only by the Congress itself but by the administration.

The committee knows full well that, while FIRREA did not mandate specifically, it gave the RTC the authority to provide subsidies if necessary to meet the goals of the statute.

The strategic plan did not, as Mr. Robson pointed out, provide the subsidies for low- and moderate-income housing, but the Board has committed, Mr. Chairman, to considering the type of subsidy, particularly price discounts or other specific subsidies if they are needed to meet our housing objectives.

With all due respect to previous statements on both sides of this issue, Mr. Chairman, I believe sincerely that we can be both socially responsible, conscious of our commitment to housing and homeownership and helping low-income people, and still maximize our responsibilities to the taxpayer of the country, as well as to prudent and responsible business practices.

We have approved, as John pointed out, Mr. Chairman, a pilot program submitted by the RTC under which we will offer the first 100 houses for sale to low- and moderate-income families. The program will be implemented within—it will be started next week.

RTC has asked the Governor of every State in our Nation to designate the State housing authority as a clearinghouse for this program, and we intend to make sure that nonprofit organizations are also designated as clearinghouses.

The RTC is developing, as well, Mr. Chairman, guidelines for selling multifamily properties to nonprofit sponsors, housing agencies, and others who are willing to make them available to low- and moderate-income families. I understand that those guidelines will be submitted to the Oversight Board very soon.

HUD is working with the RTC to provide technical advice on those guidelines, and we want to make sure that interested groups, Mr. Chairman, have a chance to contribute their expertise as well.

The strategic plan provides that the Oversight Board will carefully scrutinize the results of this pilot program, to ensure that our affordable housing objectives are being met. The word "objective" is important, Mr. Chairman, because it signals that we are looking for results, not just some strict, technical compliance with the statute.

Toward that end, the Oversight Board has requested extensive data from the RTC on these early marketing efforts, so that we will be able to review the full range of information on the eligible houses and those multifamily units.

We expect to learn how well the program is serving low-income and moderate-income families, and how the clearinghouses are able to help the buyer. And I want to assure you and all the members of your committee, Mr. Chairman, that we at HUD are working with the RTC, and I as the Chairman of the Federal Housing Finance Board, at least until the permanent Chairman is named—and I have made my recommendation to the White House of a very distinguished and able woman, Mary Bush, who is now managing director of the Federal Housing Finance Board, to be that Chair.

We have also requested that the RTC evaluate the results of that pilot program, sales program, by May 30 of this year, so that we can fully determine what further steps, Mr. Chairman, are needed to be taken to achieve FIRREA's affordable housing objective.

In closing, we want this committee to know that we do support the FIRREA vision of a network of partnerships with State and local agencies, national and local nonprofits, and other housing providers, to ensure that there is a coordinated effort to meet the low- and moderate-income housing goals.

I have directed my staff, Mr. Chairman, personally, to work with the RTC, to explore the ways in which we can take advantage of the resources of the groups that are willing to participate in this mission. We want to ensure that there are comprehensive plans for both single- and multifamily property disposition, as well as this affordable housing effort.

I am pleased that my FHA Commissioner, Austin Fitts, is providing guidance based upon the institutional knowledge at FHA on this very important issue. And we have committed all of our field offices and our personnel in the HUD field offices to working with the RTC around the country, Mr. Chairman, to help tailor efforts in differing market conditions, which has been on the mind of so many members of Congress, as it is I know on the minds of the Governors and mayors of the different areas of our country.

We are also actively working, Mr. Chairman, with other agencies, including VA, Fannie Mae, Freddie Mac, and as I pointed out, as Secretary of HUD and as Chair of the Federal Housing Finance Board, we want to find every available way to make certain that the affordable housing program works.

We think, as I said before, that it does not conflict with the prudent and responsible disposition of assets that has been required by the Congress to the RTC. And I want to assure this committee, and I look forward to participating with Mr. Greenspan and Mr. Robson in the questions that will come.

The CHAIRMAN. Very good.

[The prepared statement of Jack Kemp follows:]

STATEMENT OF SECRETARY JACK KEMP
BEFORE THE
SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS
CONCERNING THE
OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION

Mr. Chairman and members of the Committee. It is a pleasure to appear before you as a member of the Oversight Board.

Mr. Chairman, FIRREA contains specific provisions to ensure that the thrift industry will continue to meet its traditional goal of providing financing for affordable housing in this country. Also, by strengthening the Community Reinvestment Act and other anti-redlining laws, Congress has taken a strong stand against unfair and unacceptable lending practices. We are working hard to meet Congress's mandate and the mandate of this Administration to make affordable housing available and to encourage greenlining.

We were pleased to be with President Bush on January 19 in Atlanta when he appeared before the Home Builders. He made clear what he -- and this Administration -- feels about unfair lending practices when he said: "It's wrong to draw a red line around the inner city. It's not right or fair. And we're going to replace the red line with the green line for opportunity and jobs in the future."

Mr. Chairman, Mr. Robson has covered the highlights of our final strategic plan. I would like to take a moment to touch upon an area of particular importance to me and our mission at HUD.

I am aware, as you are, Mr. Chairman, that FIRREA mandates the RTC to "maximize the preservation of the availability and affordability of residential real property for low- and moderate-income households."

On the subject of affordable housing, Mr. Chairman, let me say that while we did not go as far as some may hope, we laid the groundwork for further progress ahead. As the Committee knows, FIRREA does not mandate, but rather gives RTC the authority to provide subsidies if necessary, in order to meet the goals of the statute. The strategic plan does not provide subsidies for low and moderate-income housing at this point, but the Board has committed to considering price discounts or other specific subsidies if they are needed to meet FIRREA's housing objectives.

We have approved a pilot program submitted by the RTC, under which the RTC will offer the first 100 houses for sale to low- and moderate-income families. RTC will begin to implement this program within the next week. RTC has asked the governor of each state to designate the state housing agency as a clearinghouse for this program; we intend to make sure that nonprofit organizations are also designated as clearinghouses.

The RTC is also developing guidelines for selling multifamily properties to nonprofit sponsors, housing agencies, and others who are willing to make them available for low- and moderate-income families. I understand that those guidelines will be submitted to the Oversight Board very soon. HUD is working with the RTC to provide technical advice on the guidelines. We want to make sure that interested groups have a chance to contribute their expertise as well.

The strategic plan provides that the Oversight Board will carefully scrutinize the results of the pilot programs to ensure that our housing objectives are being met. The word "objectives" is important because it signals that we are looking for results, not just some strict technical compliance with the statute. Toward that end, the Oversight Board has requested extensive data from the RTC on these early marketing efforts. We will be able to review a full range of information on eligible houses and apartment buildings. We expect to learn how well the program serves low- and moderate-income families and how the clearinghouses are able to help buyers. My staff at HUD is working with the RTC to help them design the data collection process.

We have requested that the RTC evaluate the results of the pilot sales program by May 30, 1990 so that we can determine what further steps need to be taken to achieve FIRREA's affordable housing objectives.

We want you to know that we support FIRREA's vision of a network of partnerships with state and local agencies, national and local nonprofit groups and other housing providers to ensure a coordinated effort to meet our low and moderate income goals. I have directed HUD staff to work with the RTC to explore ways in which we can take advantage of the resources of those groups that are willing to participate in this mission of providing affordable housing.

We also want to assure that there are comprehensive plans for efficient single and multifamily property disposition and the affordable housing effort. FHA has provided guidance based on its knowledge and experience. We are committing HUD field office personnel to working with the RTC around the country to tailor efforts to differing market conditions; and we are actively working with other agencies, including the VA, Fannie Mae and Freddie Mac to find ways to make the affordable housing program work.

Mr. Chairman, the mission that Congress has given to us at the Board reflects a strong commitment to housing. The plan we are presenting today is an important building block in the solution to a terribly complex problem. We look forward to working with you and the members of this Committee to meet the policy mandates established by Congress in FIRREA.

The Chairman. We appreciate that statement. You are on this Oversight Board in large measure to do precisely that you have just described, and so that is a helpful progress report.

Mr. Robson, let me ask you, does the Board have the clear and sole authority to make the decision on working capital on the means by which you will raise the working capital and the amount that you will raise? Do you see yourself as having that authority?

Mr. Robson. There are some legal issues which we are now clarifying, Mr. Chairman, with the Office of Legal Counsel at the Justice Department. Once those are resolved—and I hope, favorably—we would see ourselves going forward with a working capital plan. If the suggestion is, is there any further legislative action needed, the answer to that would be, "No."

The Chairman. Well, I do not think there is. I want to know where the decision responsibility is, and I take it that it is with the Board.

Mr. Robson. Yes.

The Chairman. It is your view that it is with the Board.

Mr. Robson. Yes.

The Chairman. And how close are you to a decision? Did I understand earlier that maybe within 2 weeks we will have a bottom line judgment by the Board on both the way in which working capital would be financed and the amount that will be financed?

Mr. Robson. Certainly, we will have, I think, the methodology for its financing. Whether we will be able to refine further the exact amount that we are going to need over the entire life of RTC is a more difficult question. But within the next 2 or 3 weeks, we will make a decision on the methodology, and we will at that time brief Congress fully.

The Chairman. All right.

And that decision resides within your group as a policy board?

Mr. Robson. That is correct.

The Chairman. That is your understanding. And so we will hear that recommendation from you.

Now, does the RTC today have cash resources available to it to do the things that they are asking to do under your direction?

Mr. Robson. We believe that they do.

The Chairman. Do they believe they do? Are you hearing from them?

Mr. Robson. Bill Seidman is here, and you will hear from him tomorrow.

The Chairman. He will come up today.

Mr. Robson. I think, as I said in my testimony, Mr. Chairman, we believe that the resources that have been provided by Congress are adequate for the RTC to proceed full-speed with the job ahead. If ultimately—which I hope is not the case—the cost proves larger, that is something that is substantially down the road.

The Chairman. I am going to get to that in just a minute. But I want to nail down the working capital issue. So your judgment, the policy board's judgment, is that the working capital that you need today, this week and next week, is sufficient to today's operations?

Mr. Robson. Yes.

The Chairman. That more will be needed here shortly——

Mr. Robson. Yes.

The CHAIRMAN [continuing]. But that you have no working capital problem at the moment? Is that your testimony?

Mr. ROBSON. That's correct.

The CHAIRMAN. And is it your judgment—and I am going to ask Mr. Seidman as he comes to the table next whether or not that is his view, too. But it is your judgment that we will get the same testimony from him?

Mr. ROBSON. If it is not, I will be surprised.

The CHAIRMAN. All right.

So we will have that recommendation from you within the next 2 and 3 weeks. You will present it to the Congress, both on the amount of working capital needed and also the manner in which you intend to have it done.

Now, with respect to the total cost—and of course, these are estimates, because we will not know that until we wind on through this problem—last year, I wrote to Secretary Brady and to Mr. Seidman both in the course of the development of the legislation, to get a final update as to their best estimate as to the amount of money needed ultimately to resolve the problem.

And as you know, the request from the administration was for $50 billion. I am going to put both letters, the response by them, into the record.

[The letters referred to follow:]

THE SECRETARY OF THE TREASURY
WASHINGTON

June 23, 1989

The Honorable Donald W. Riegle, Jr.
United States Senate
Washington, DC 20510

Dear Don:

Thank you for your letter, dated May 25, 1989, concerning the thrift legislation. We appreciate your active leadership on the Financial Institutions Reform, Recovery and Enforcement Act of 1989.

Your letter states the concern that the legislation may not provide sufficient funds to deal with the problem. The Administration's plan calls for $50 billion for case resolutions by the Resolution Trust Corporation (RTC) for thrifts that have been or will be placed in conservatorships or receiverships from January 1, 1989 until three years after the date of enactment. During this period, a $5 billion emergency line of credit from the Treasury will also be available. From October 1991 through 1999, the plan provides an additional $24 billion for case resolutions as well as $8 billion to capitalize the Savings Association Insurance Fund (SAIF). We believe -- as does the Federal Deposit Insurance Corporation (FDIC), General Accounting Office and the Federal Reserve -- that these resources are adequate to do the job.

When the Senate Banking Committee thoroughly examined this issue, both in hearings and at the staff level, the numbers underlying our conclusions and the assumptions that were used were explained in detail. This appeared to satisfy the Committee's concerns at the time, since no amendments were offered to increase the amount of funds for case resolutions and the bill passed by a unanimous vote.

We, too, are familiar with the information contained in a recent FDIC report which you suggest might indicate that the resolution costs for RTC cases over the next three years may exceed $50 billion by a substantial amount. The FDIC's report contains an estimate, based on its on-site examination, of $29.8 billion in losses at 212 thrifts that are currently in receiverships or conservatorships. But, when he released that report, FDIC Chairman Seidman said that "this level of loss is consistent with the Bush Administration's estimate of losses in all insolvent institutions to be handled by the Resolution Trust Corporation."

It is also my understanding that the General Accounting Office, in recent discussions with Banking Committee staff and others, declined to conclude that the amounts provided for under the Administration plan are inadequate.

Finally, our most recent reexamination of thrift data supports our earlier conclusion that $50 billion for RTC cases over the next three years is sufficient.

Based on this broad consensus, I continue to believe that the resources provided by the Administration's plan are adequate. Let me emphasize, however, that this level of resources, no matter how thoroughly researched or widely agreed upon, is still based only on estimates. Uncertainties include the level of interest rates, the strength of the economy, as well as many other factors that could have a significant impact on the size of the problem. As a result, the actual cost of case resolutions could be higher or lower, depending on the actual circumstances. In summary, we feel the resources provided for in the Administration's plan and in both the ~~Senate and~~ the House bills are reasonable given these uncertainties.

Your letter also asks what contingency approach would be used if the size of the problem exceeds $50 billion. As I mentioned above, the RTC has a $5 billion line of credit from the Treasury -- and as a practical matter it is doubtful that the RTC could efficiently spend more than $55 billion on resolution costs on RTC cases over the next three years. Furthermore, under both the Administration plan and the Senate bill, $24 billion will be available for thrifts that fail three years from the date of enactment, and this would not affect the build-up of $8 billion to capitalize SAIF by 1999. Finally, the legislation specifically provides the FDIC authority to raise premiums to handle additional cases in the event of extraordinary circumstances.

While we believe these resources are sufficient for all reasonable contingencies, your letter also asks what would happen if the resources were exhausted. In that event, it would be necessary for Congress to revisit the issue. I believe this is appropriate: if circumstances were to change so dramatically, Congress should indeed take a second look. In fact, the Senate Banking Committee took the same view when it voted at the end of the mark-up of S.774 to cap the ability of SAIF to spend more than $24 billion from 1991 to 1999 without receiving permission from Congress. If your view has changed, however, and you want to ensure that additional contingency resources are available without returning to Congress, the conferees could of course decide to increase RTC's contingency line of credit.

Let me mention one related point, which concerns the House bill's cap on the authority of the RTC to issue notes and guarantees for working capital purposes. I understand the Congressional concern to impose such a cap, particularly in view of last year's experience with FSLIC, where notes and guarantees were issued on the questionable strength of future premium income. I have no objection to a cap that would prevent the RTC from taking similar actions. However, the cap imposed by the House bill is far more restrictive and could create the following anomalous result: the RTC would be forced to seek more funds simply for working capital purposes from Congress as early as next year, even though it would own substantial amounts of real estate and other tangible assets.

A cap that prevents borrowing on the strength of tangible assets owned -- even though the taxpayer would not be at risk -- is likely to force Congress to revisit this whole issue prematurely. I urge you to consider this matter very carefully as we approach the conference between the Senate and the House of Representatives. We would be happy to work with you to design a cap that would avoid unintended consequences.

In summary, I continue to believe that, in the absence of strong evidence to the contrary, an appropriate level of resources is included in the Administration's plan, as embodied in the Senate bill.

I look forward to working with you in the conference to produce a strong, bipartisan bill that maintains the essential provisions of the Administration plan.

Sincerely,

Nick

~~Nicholas F. Brady~~

FEDERAL DEPOSIT INSURANCE CORPORATION, Washington DC 20429

OFFICE OF THE CHAIRMAN

June 26, 1989

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
 and Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am pleased to respond to your June 8th letter in which you expressed concern regarding the RTC's funding needs and the level of interest rate risk in the institutions under conservatorship.

The FDIC has estimated that RTC may have to deal with S&Ls holding $300 to $500 billion in assets. This assumes that RTC would be responsible for old FSLIC and the transactions previously arranged by FSLIC that require ongoing support. (FDIC has advocated the placement of old FSLIC into RTC, but that is not the structure in either bill.) Such transactions involve about $130 billion in thrift assets, half of which are protected under yield maintenance arrangements. The $50 billion funding however, is not earmarked for prior transactions but for new case resolutions.

No one can predict with certainty whether $50 billion is enough to cover the losses at the S&Ls likely to need resolution over the next three year, since costs depend on predicting the future; e.g., economic conditions, interest rates, and property values. At this time, we believe $50 billion is a reasonable estimate upon which to base legislation.

Another factor in determining how much money will be needed is the number and size of S&Ls going to RTC for resolution. RTC handles failures only during the first three years; failures after that would be handled by SAIF. The earlier FDIC table you referred to provided estimates of the cost of failure of all S&Ls with no tangible capital -- including profitable ones -- as well as unprofitable S&Ls with less than three percent tangible capital. It is not likely that all of these S&Ls will fail in three years, and some may recover and survive. Thus, it is difficult to project exactly how many S&Ls the RTC will have to handle.

For your information, we have enclosed the latest results of our model which used fourth quarter data to estimate losses for 428 S&Ls that appear most likely to go to RTC. These include all RAP-insolvent, GAAP-insolvent, and unprofitable tangible-insolvent S&Ls. The model suggests these S&Ls with assets of $180 billion could be handled for $44 billion. Note the loss rate for the RAP insolvent and unprofitable S&Ls averaged 37 percent of assets. This appears reasonably in line with the $30 billion or 40 percent loss rate indicated by our on-site reviews of the RAP insolvent and unprofitable S&Ls under conservatorship.

Based on our on-site reviews completed thus far, it appears that $50 billion will be enough, though there does not appear to be much of a comfort margin.

The rate at which funding will be necessary is also difficult to predict. It depends on how quickly institution problems can be resolved. We believe your bill makes a reasonable estimate of resolution needs.

While $50 billion appears to be a reasonable estimate of ultimate cost, we want to point out that RTC likely will need considerably more than $50 billion to provide working capital to effect resolutions. To explain, the S&Ls on the enclosed list are funded by about $180 billion in deposits and borrowings, but about half of their assets are either troubled or non-traditional thrift assets. In an ideal world, RTC would find buyers willing to assume all liabilities in return for $50 billion plus all the failed thrifts' assets. That simply is not going to happen. Interested S&L buyers we have talked with thus far have been reluctant to accept anything but traditional assets and cash.

Moreover, depositors may claim their insured deposits at any time, and RTC must have the cash to meet those demands. For some S&Ls, the only viable option will be to pay off all depositors and liquidate the assets. Thus, the RTC will need access to enough funds to satisfy S&L depositors and other liabilities while assets are being liquidated.

RTC must have the ability to raise cash or provide cash-equivalent obligations To meet these demands, we believe the RTC should be able to issue obligations with the backing of the full faith and credit of the U.S. government. The amount of such federal guarantees should be limited by placing restrictions upon the RTC similar to those the proposed legislation would place on the FDIC. Thus, this limitation would restrict RTC's authority to issue obligations by providing that RTC must have resources available to repay those obligations without further appropriations.

Finally, we share your concern about the interest-rate exposure of S&Ls under FDIC supervision. Substantial exposure does exist. For S&Ls in conservatorship as of April 15, year-end 1988 data indicate that liabilities repricing within one year were about $64 billion, compared with repricing assets of $25 billion. Liabilities repricing within three years were $75 billion, compared with assets of $30 billion. Our policy is to reduce exposed positions as soon as possible; but under current conditions, funding remains short-term, while most assets remain long-term.

Some of the S&Ls have engaged in hedging strategies, and we have encouraged this effort where appropriate. Our present belief is that the expense of hedging may not be justified in many situations. We will continue to monitor rate risk, with a view to reducing interest rate exposure.

Do not hesitate to call if you should want to discuss these issues further.

Sincerely,

L. Wm Seidman

L. William Seidman
Chairman

Enclosure

YEAR-END 1988 COST ESTIMATES FOR INSOLVENT S&Ls
TEN PERCENT LOSS ASSUMPTION ON RESIDENTIAL MORTGAGES AND MBSs
($ BILLIONS)

	S&L Group	Number	Gross Assets[1]	Annual Liabilities	Annual Income	Cost Estimate	Cost to Assets
(1)	RAP Insolvent & Unprofitable	232	$75.1	$79.6	$-7.0	$27.7	.37
(2)	RAP Insolvent & Profitable	5	4.3	4.2	--	0.7	.16
(3)	Total RAP Insolvent (1+2)	237	79.4	83.8	-7.0	28.4	.36
(4)	Other GAAP Insolvent & Unprofitable	91	32.4	30.9	-0.5	5.3	.16
(5)	Other GAAP Insolvent & Profitable	36	10.0	9.5	--	1.6	.16
(6)	Total Other GAAP Insolvent (4+5)	127	42.4	40.4	-0.5	6.9	.16
(7)	Total GAAP Insolvent (3+6)	364	121.8	124.2	-7.5	35.3	.29
(8)	RAP + GAAP > 0 Tangible Insolvent & Unprofitable[2]	64	58.1	54.0	-0.6	8.7	.15
(9)	Total RAP + GAAP Insolvent + Tangible Insolvent and Unprofitable (7 + 8)	428	179.9	178.2	-8.1	44.0	.24

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[1] Gross assets include general and specific valuation allowances, loans in process, deferred loan fees and valuation allowances for mortgages held for sale.

[2] Tangible net worth is defined as GAAP capital minus all intangible assets other

The CHAIRMAN. Both letters indicated that at that time—now this would have been in late June 1989—that the $50 billion was going to do the job. That was their best judgment.

And it was said slightly differently in each letter, and I will not take the time to read those letters. But with respect to your best policy judgment now as to the ultimate cost being within the $50 billion sought, or now being seen on the basis of later information as likely exceeding that by some amount, would it be the view of the policy board that $50 billion will still be sufficient to see this thing through? Or, is a later look inclining you to think now that the ultimate cost is going to exceed that amount?

Mr. ROBSON. Let me answer your question in the following way. The $50 billion estimate was based on the estimates of the FDIC, the Federal Reserve, and several others.

Those were the best estimates available at the time we stepped forward and said, "Let's solve this problem." Secretary Brady then said last October in this very room——

The CHAIRMAN. Right.

Mr. ROBSON [continuing]. That it is possible that the $50 billion to resolve the 3-year period of RTC resolution will not prove to be enough. That could mean two things. One, it could mean that more thrifts will fail earlier, and therefore resources that were originally contemplated to be spent after 1992 will be spent earlier, but therefore will not be needed later. Or, it could mean that the ultimate cost of the problem will be greater than we orginally estimated.

We have no interest in trying ultimate to hide the pea under the walnut shell. We did not know the true cost when we put the figure forward in February 1989. We do not know now. Our goal is to get forward, and get this job done. And I agree with the sentiments that have been expressed around here, that time is money in this case.

Today, we are not facing any shortage. Today, we can move ahead quickly. When we have become convinced that we are going to need more resources to continue the resolution of failed thrifts, we will be here—and I hope we are not. But we will have no choice, because the full faith and credit of our Government stands behind all deposits of up to $100,000.

The CHAIRMAN. Well, I want to pursue it just for a minute. Because the $50 billion figure was seen as the figure to resolve the whole problem, not just over a 3-year span of time, but the thought was that the ultimate resolution cost, working capital to the side, would be contained within the $50 billion.

Now, listening carefully to what you just said, I get the sense—and I think there is a growing amount of commentary out there that suggests that we may be looking at something that is more than that, in terms of what the public may be asked to supply here.

Is that what I am hearing you say?

Mr. ROBSON. What I said to you is—and I will say it right now—that the cost could be in excess of $50 billion for the segment that that $50 billion was designed to cover, Mr. Chairman. And remember, there is the $32 billion that comes after 1992. So that there is segmentation of the resources that were provided by Congress.

But as I said in my testimony, the OTS, which keeps a watch list on the thrift industry, has indicated that they are going to add some more to that list, that may be in the probable or likely to fail category. If those in fact do fail, and if they are costly when they fail—and that may not be the case, because the thrifts that are coming into the process now have much smaller negative net worths than the thrifts that came in at the beginning of the process—it could cost more.

And I do not want to sit here and have it ever be said, "By God, Robson came up here and told us, 'It was $50 billion, period'." Because it could be more. And circumstances of the economy, circumstances of interest rates, and a variety of things, can affect that.

The CHAIRMAN. Well, it is a very important question. I want to pursue it just one more step with you, Chairman Greenspan. And that is that there are other things happening at the same time. We have got a very dynamic economic situation. We have just had an up-tick in interest rates, apparently driven in some considerable measure by events outside our country—namely, interest rates going up in other countries, and having the effect of helping to drive up interest rates in this country.

The cost and the difficulty of resolving the S&L problem relates to where interest rates are. The higher interest rates are, the more it makes our problem difficult, and in effect over time more expensive. So this is just one of several areas that are impacted by any upward pressure on interest rates.

I want to ask you, Chairman Greenspan, with respect to the question—because I have great regard for your sense to analyze financial numbers and circumstances—as to whether or not you think that we are looking at an ultimate resolution cost above $50 billion.

We have got a new budget here. Many of us serve on the Budget Committee, as I do. And one of the question is, what do we have to have in mind as an obligation to solve this problem, to fit into the puzzle of what our available resources are?

As you testify today, are you confident that $50 billion is going to be sufficient to get this job done?

Mr. GREENSPAN. Mr. Chairman, I would just reiterate what Secretary Robson has said.

We do not know a very great deal more than we knew earlier, largely because we have as yet to get a large enough sale or set of sales of assets into the market, to get some judgment as to what the discounts are from either book or appraised values of these various different properties.

And until we have a significantly larger sample to work with—that is, until the RTC has a sufficiently larger sample to work with—we are essentially reviewing the data that we had at an earlier time, and really adding or subtracting a few associations here or there, and altering the judgments of the ultimate discounts, the so-called "hair cuts," off the properties that are on those books, very modestly. So we do not have fundamentally new data with which to deal.

The estimates I think will improve very substantially, and get refined very substantially, when those numbers start to come in. And until we get those data, I think that we are making judgments in a very broad range. And I think that Secretary Robson described the dilemma that we have at the moment, I think, quite correctly.

I understand and I very much appreciate the Senate and the Congress' desire to learn as quickly as possible the updated estimates that would be involved in such calculations. But I think prior to that, our obligation really is to make certain that we do not slow down the process of resolution because of inadequate funds.

And I think that, as Secretary Robson has stated, the moneys that are currently available are adequate to move forward in a way which will ultimately resolve these issues, and we do not need at this particular stage to know exactly what that number is. It is an interesting number to have, and I think ultimately crucial for the Senate and the Congress to have; but from an operational point of view, that is not a number that we at the Oversight Board or at the RTC need for expeditious implementation of the particular goals of the organizations.

The **Chairman**. Well, I will just make a comment before yielding to Senator Garn.

As you recall, we had a major debate in the Congress, and between the Congress and the administration, as to how we were going to account for the money in a budgetary sense, whether it was on-budget or off-budget. And as a matter of fact, there obviously is a difference in financing cost, as to whether we finance directly, which tends to correlate to being on-budget, rather than financing indirectly through a sort of an arm's-length financing mechanism.

And these costs become very important to us. We have just gone through a Treasury financing that has been referenced earlier, that appears to have had some problems associated with it. And if we are going to see a situation any time soon where there is a need for a greater amount of money, in terms of the basic amount that is available separate from the working capital side, the question of how that is to be accommodated both with respect to the financing and on-budget, off-budget, and how it is to be accommodated within Gramm-Rudman-Hollings budget targets, which is an order of the day issue, is not something anybody can sidestep or slide by. That is a very powerful, central question that is right in front of us.

And the sooner we have updated information that helps us lay out a plan going down the road for how this is to be budgeted, how it is to be financed, how we get the low-cost financing, is very important. It certainly affects, I think, the latitude of even the Federal Reserve Board, because this becomes one more financing requirement that has to go out into the market, at a time when conditions are somewhat volatile.

Mr. **Greenspan**. If I may address that, Mr. Chairman, I think that we have to focus on the working capital needs in a very special way.

The basic purpose of Gramm-Rudman, the basic purpose of reducing the Federal budget deficit, is essentially to raise total domestic savings in our society. Transfers of assets do not affect the net new savings rate in the economy. Accordingly, in the special calculations that are made in conjunction with the Gramm-

Rudman law and the Federal budget deficit, we should exclude such items as working capital needs for the RTC.

And so, I would suggest recognizing that the working capital is not a factor which fundamentally affects savings rates and that it should be considered off-budget at least for Gramm-Rudman purposes.

I would be more concerned, not in terms of the increase in the borrowings that occur and which would, if it were on-budget, increase the unified budget deficit; I am more concerned when the working capital unwinds and goes back into the Treasury as receipts.

If it is on-budget at that time, it will create a very significant decline in the unified budget deficit, and perhaps give a false sense of the improvements that are occurring in the process of fiscal policy.

So in scoring the working capital needs, I would suggest that we be careful not to allow it to contaminate our Gramm-Rudman process, or the budget process overall, remembering that the fundamental purpose of our desire to get the deficit down is to increase domestic savings. And in that sense, one has to view the working capital independently as a balance sheet item, and not as an item which is, or should be, directly add-able, to the basic Federal deficit.

The CHAIRMAN. You know—and I am going to yield to Senator Garn—you have just made a very powerful argument, working capital aside, for the basic loss to be treated on-budget. That may not have been the point that you started out to make, but I think the reverse side of the argument that you have just made with respect to not allowing false pictures to be presented by transfers in and out of working capital, would apply just as strongly as to why we need to have an accurate picture in terms of real losses, in terms of on-budget, in terms of the basic cost of this, separate and apart from working capital.

I do not know that we should debate it at great length, but that is the view I draw on that very important related point.

Mr. GREENSPAN. I do not want to raise the issue now, but I think there is a related question, which gets to the issue, which is secondary to this; namely, in evaluating the Gramm-Rudman process and the longer term move toward a balanced budget, there is a second category which is essentially the question of one-shot type of losses in here. And even that, I might add, creates some budget questions which I do not think we ought to get into at the moment.

But I would reiterate my original recommendation early on, when the legislation was under discussion, that in fact even that be off-budget for purposes of long term budgeting. But I do not want to re-raise that issue now, because I think that will take us far afield.

The CHAIRMAN. It may come back here.

Senator Garn.

Senator GARN. Thank you, Mr. Chairman.

I would only make one comment on that issue. After all these months, I have still not decided, very frankly, whether the administration's off-budget financing proposal is phonier than Congress' to have it on-budget but not count it under Gramm-Rudman-Hollings.

I still have not figured out which one was phoney. Both of them, in my opinion, were a phoney method of accounting.

I realize that I am going to sound like a broken record on this particular issue, to follow up on what the Chairman is saying about the ultimate cost, and whether $50 billion is sufficient.

I would say at the outset, I do not think it is. I do not question your sincerity, but after sitting around this dais for the last 10 years or so and talking about this problem, there have been a lot of very sincere people who have done the very best job they could in estimating the size of the problem, and they have all underestimated it.

Even Bert Ely, who has sat here many times and testified—and when he used to testify, and his estimates were much higher than GAO's, and the Treasury, and the FDIC, and FSLIC, and everybody else—even Bert Ely, who was the highest one, was wrong.

So just on the basis of not being an economist or understanding all the things that you do, Mr. Greenspan, I do not think you have to be too bright around here to figure out, and we just ought to assume, we ought to plan that it is going to be more than $50 billion.

But again, I do not question what you are saying at all, because I do not know how anybody can come up with a specific figure. I remember you testified once last year and said, "If you can tell me what the prime rate is going to be for the next 30 years, I will tell you what the ultimate cost will be." So we do not know what the prime rate is going to be, we do not know how fast the RTC is going to be able to resolve these situations, how much they will get for the properties. There are so many variables that I do not think anybody can pick a specific figure and say that that is going to hold.

And when we used to hold these debates—and this is where I am a broken record, over and over again—while I do not disagree with the Chairman that it is important to us and the taxpayers to know what the ultimate cost is going to be, if it is impossible to put an exact figure on that it always seemed to me that speed was the most important thing.

We were talking about this back in 1983, in 1984, and what I recited earlier, the Chairman and I in the middle of the night on the Senate floor back in 1986. At any point in this process, whatever the ultimate figure is, it would have been less if we had acted.

Years have gone by without acting. And I think I used the expression that, if you are hemorrhaging to death, it is most important to get the tourniquet on. If you put it on too tight, you loosen it. If you did not put it on tight enough, you tighten it later. And I still think that is the same process. That ought to be evident to everybody, that we have a big problem, and it is going to get worse before it gets better.

That gets back to my opening comments and my opening statement: speed is the most important thing we can do. The quicker we get that tourniquet on, whatever the ultimate cost is going to be, whether it is $50, $55, $60, or $75 billion—I do not know, nobody else knows. But the sooner we do the job, the less it is going to cost.

And I guess that is why I feel so much frustration about what happened in 1986. If Congress had acted then I do not know what the size of the problem would have been, but it certainly would not be as big as it is now. And it is not going to be as big 2 years from now, if we get on with it.

So again, I hate to sound like a broken record, but I simply have to—out of years of frustration—have to emphasize.

One thing I would agree on with the Senator from Texas, act decisively, do not be timid, do what is necessary. You get less criticism from Congressmen and Senators if you are trying to do the job and make mistakes, than if you just seem to drift on and on and are not addressing the problem.

There have been statements that the Oversight Board has somehow caused the delay. I would like you to respond to that criticism, if you have been part of the reason for the delay. And if you have not, I am still disturbed that things are going slowly.

And I understand from our conversation yesterday, Mr. Robson, all of the problems that you have and difficulties of getting a new agency started, but surely, surely there must be something you can do to speed up the process—agreeing with the problems of getting a new agency going, agreeing with the difficulties of a bureaucracy. All of that, and the magnitude of the problem.

So if you will respond whether you have been part of the delay problem, and if not, tell me how you can speed up the process. There has simply got to be some way to do it.

[Response to Senator Garn's question follows:]

THE DEPUTY SECRETARY OF THE TREASURY
WASHINGTON

January 31, 1990

The Honorable Jake Garn
United States Senate
Washington, D.C. 20510

Dear Senator Garn:

This responds to your inquiry regarding the question of whether the Oversight Board may have occasioned delay in the resolution of insolvent thrifts by the Resolution Trust Corporation (RTC). We and the RTC share the concern of Congress that the process of thrift resolution goes forward expeditiously as contemplated by the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA). We welcome this opportunity to provide you our thoughts on the subject.

In reviewing the brief history of the Oversight Board and the RTC since their establishment last August, we can see a number of factors that affected the thrift resolution process. However, we do not find a basis for concluding that the Oversight Board has been the instrument of delay in thrift resolutions.

First, it is important to bear in mind that under FIRREA, the Oversight Board does not get involved in the RTC's day-to-day operations nor in any individual thrift resolutions.

In addition, in the first three months, the RTC has received funds from the Oversight Board for thrift resolution and other purposes very quickly after they were requested -- after appropriate review of supporting documentation. This review and disbursement process normally took less than one day. After November 1989, funds were transferred to RTC based on the Oversight Board's approval of a quarterly RTC operating plan.

In one instance, at the close of the 1989 fiscal year, RTC had informed the Oversight Board that it expected to complete certain large thrift resolutions by the end of the fiscal year. However, RTC subsequently determined that for reasons having to do with the expansion of the bidding process, it would not be able to complete these transactions on schedule. As a result, funds which had been initially requested were not disbursed until the RTC was able to complete these transactions a few weeks later.

As you are aware, FIRREA vests the Oversight Board with authority to set general policies for the RTC that may govern certain aspects of thrift resolutions. At times, the policy development process, which is conducted in consultation with RTC, can take time. However, both FIRREA and explicit policy of the Oversight Board prescribe that for all situations in which no Oversight Board policy has been issued, the RTC is to follow the policies and procedures of the FDIC. These transitional rules were specifically enacted to avoid delays in the start-up process due to the absence of Oversight Board policy. So we do not believe that the policy development process has caused any delay in RTC thrift resolution.

We believe the pace of case resolutions is influenced by a number of other factors. There are numerous insolvent thrifts and the complications relating to an open bidding process designed to attract the maximum number of potential buyers makes the resolution process necessarily time-consuming. In addition, the due diligence examination required by buyers in purchasing thrift assets can also take substantial time. Finally, RTC has had to establish a large regionalized organization while simultaneously tackling the job of cleaning up the thrift industry.

We believe that the factors just mentioned are the principal ones which have governed the pace of thrift resolution by the RTC in these early start-up months. It was, therefore, surprising that recent RTC testimony before the House Banking Committee suggested that delays in thrift resolutions by the RTC had been occasioned by a protracted Oversight Board decisional process. In the interest of promptly resolving any issues that might contribute to delays, the Oversight Board has invited the Chairman of the RTC to meet and discuss these matters directly with the Board members and specifically identify instances where delays may have been occasioned by Board action or inaction.

The job ahead for the RTC and the Oversight Board in carrying out the responsibilities of FIRREA is of sufficient magnitude to make it imperative that we work together effectively and harmoniously. The Oversight Board will continue to attempt to carry out its responsibilities in an objective and efficient manner.

We appreciate the opportunity to respond to your concerns and I look forward to working with you and the Committee in the future.

Sincerely,

John Robson

John E. Robson

Senator GARN. I do not want to be sitting around here giving this same speech 3 years from now, and rereading my comments about how it was an urgent problem, but now it is a $100 billion problem. I do not want to do that again. I am tired, I am frustrated, with years—a long time before any of you were here—Jack was in the Congress. But this is not a problem of the last 5 months, or the last 2 years. It started in the late 1970's, and it goes on and on and on. And we have had a Government, a Congress, administrations—four of them—that have not adequately dealt with the problem.

It is time to do whatever is necessary—decisiveness, boldness, I do not know, but there has got to be some way to speed up this process.

The CHAIRMAN. Mr. Robson.

Mr. ROBSON. Well, let me just say first that I do not believe that there is a basis for saying that the Oversight Board has been the occasion for delays. The Oversight Board does not do resolutions; the RTC does them. We have an oversight responsibility.

We have given them the money when they needed it. The policies that we have worked out have been done I think quickly, and where they have taken some time, the RTC is free to operate under FDIC's policies.

Having said that, I do not know that that is an adequate answer. Because the problem is one that is all of ours. And I share your belief that this job needs to get done expeditiously.

I think that there are some reasons why the pace has been a little slower than some of us might have liked to have seen. It was a start-up operation. It has only been going for 5½ months. The RTC has had to build a nationwide regional organization, while at the same time trying to do the resolutions. The bidding process is complicated. When you try to cast your net wide, it takes time. The due diligence that bidders do takes time.

These are all reasons. But again, I think that the answer to your question ought to be, Senator Garn, I think the pace of resolutions is improving. I think it will get quite a lot faster—and Mr. Seidman can confirm that, or amend it if he likes. And I share your commitment and your concerns about getting this job done. And we are going to break our necks to see that we get it done, and get it done right and quickly.

Senator GARN. My time is up, Mr. Chairman.

The CHAIRMAN. I want to apologize to my colleagues. My time ran over at the outset, because we were in the middle of a question and I wanted to try to finish. And so I will be understanding with anybody else who is in a similar situation in terms of time.

Senator Graham.

Senator GRAHAM. Thank you, Mr. Chairman.

Mr. Chairman, I have not been here as long as you or Senator Garn, but just as a relative newcomer to this process, to state that frustration, it was about 18 or 24 months ago that a person who had almost the exact title that you do, Mr. Robson, came to that same table, and urged us into a position of passivity relative to this problem, that it would almost be nonpatriotic if we were to attempt to move to solve what many of us thought was an emerging S&L problem.

And in that environment of tranquility, it is not surprising that nothing happened until a $10 or $20 billion problem became a $100 billion problem. It is out of that frustration that I think some of these questions are being asked.

So we are starting with a new day, with new participants, and we give to each our initial confidence and credibility. And we just urge a response of candor on this problem.

The question that I wanted to ask relates to what I think should be a key role and rationale for there being an oversight process. That is, the coordination of activities that include RTC and other agencies with analogous circumstances.

We know that RTC is not the only Federal agency with an inventory of distressed assets. HUD has got an inventory, the VA has an inventory, RTC has an inventory. What policies have you set, or are you contemplating, that would result in the various Federal agencies dealing with similar problems doing so in a way that will not compound the problem through one agency's actions undercutting another?

Mr. ROBSON. One of the first policies that we issued, Senator Graham, was one that required RTC in its disposition of properties to consult with FHA and the other agencies who have property disposition programs of one sort or another, in order to see if they can coordinate their activities and not have a discordant approach to the marketplace in particular localities.

Dan Kearney might embellish that a little. And I know that Bill Seidman, who is actually doing the selling, when he is at the table perhaps can illuminate that a little more.

Dan, would you like to add anything to that?

STATEMENT OF DAN KEARNEY, PRESIDENT AND CHIEF EXECUTIVE OFFICER, OVERSIGHT BOARD OF THE RESOLUTION TRUST CORPORATION

Mr. KEARNEY. We have also had meetings with Fannie Mae and Freddie Mac, with respect to the programs that they have with respect to the disposition of the assets in their inventory as well, Senator Graham.

Senator GRAHAM. Well, with Secretary Kemp at the table, could we focus specifically on what is happening between HUD with its large asset disposition circumstance—and I understand that HUD now has an asset recovery task force——

Mr. KEMP. Right.

Senator GRAHAM. Could you give some specific standards by which that coordination is going to take place?

Mr. KEMP. Well, Senator Graham, as I mentioned in my opening remarks, HUD is meeting regularly with the RTC, not only the RTC staff but also FHA is meeting with that staff. We have our urban homesteading staff, the homeless coordinating counsel at HUD, as well as others, who are trying to lend our experience and expertise to the RTC.

I mentioned what we are trying to do in the field, and that is an ongoing effort. As the Chair of the Federal Housing Finance Board, our Office of Community Investment, which will serve as a clearinghouse for that part of RTC's affordable housing programs that are applicable, plus the district Home Loan Bank officials throughout the country are in constant contact with the RTC.

So I think there has been established a sense of cooperation and a sense of not only of cooperation toward meeting the objective, but a willingness to pursue all avenues of making sure that our coordination meets those affordable housing needs so specifically outlined in the legislation.

Senator **Graham**. I was concerned with that issue, but also with just the scale of HUD asset disposition, the scale of RTC, that you do not end up competing with each other, and by one agency's action, undercut the value of the inventory of the other.

Mr. **Kemp**. Well, that just requires the continuing cooperation and effort by both FHA and RTC. And I just want to assure you and anyone else who is observing or listening to these hearings that that is a constant and ongoing challenge to both the RTC and FHA.

There will not be any dumping, but at the same time, we want to make sure that we do it in a prudent and responsible and businesslike way, with all due dispatch and speed. So I just again want to give you that assurance, that we are making every effort to comply with market conditions in different parts of the country.

We have about 48,000 properties in our FHA inventory. We want to obviously get them into the hands of people who can use them and have needs. We want to do it, however, in, as I said, a prudent and businesslike way.

Senator **Graham**. Thank you, Mr. Chairman.

The **Chairman**. Thank you, Senator Graham.

Senator Heinz.

Senator **Heinz**. Mr. Chairman, thank you very much.

This is a question for Mr. Robson. Mr. Robson, as I understand it, some 42 thrifts have been resolved by the RTC, leaving approximately 293, almost 300 in the present inventory to be resolved.

Now, I understand that the RTC has got a priority schedule for resolving failed thrifts. Priority—understandably, correctly—is given to those thrifts that have the highest rate of deterioration. That makes sense.

It would seem that the thrifts in the worst shape would and should be the best candidates for liquidation. If something is a basket case, you are never going to be able to sell it, so liquidation. And by the way, most of the thrifts that have been resolved so far have been liquidated in one sense or another.

My question to you, as the Oversight Board, is, of the almost 300-or-so thrifts that are now in the RTC, how many of them will most likely be liquidated? Do we know the answer to this, or should I save that for Mr. Seidman?

Mr. **Robson**. I do not know the answer to that.

Senator **Heinz**. Does anybody at the table, if you do not know?

Mr. **Robson**. And I think it would be one that would be more appropriately addressed to Mr. Seidman, Senator Heinz.

Senator **Heinz**. Let me make an editorial comment, probably an unwelcome one. But I do not see how the Oversight Board can do its job without knowing the answer to that question.

The reason is that the question that Senator Garn was asking a moment ago, regarding pace of resolution, is directly and dramatically impacted by whether or not you are doing liquidations, whether you are doing clean bank deals, whether you are doing whole bank deals.

Liquidation is quite simple. You pay off the depositors, and you hang onto the assets. You can hire someone to actually do the work for you, to pay off the depositors. And in fact, Bill Seidman has done that in a number of cases. It is not complicated.

What may or may not be complicated—and that is why I asked you the first question—is, how many of these candidates for liquidation do we have? Only then can we get a meaningful answer to Senator Garn's question. Only then can we figure out whether there is sand in the gears.

May I suggest that we find out the answers to those questions, because they are quite pertinent.

Mr. ROBSON. Could I ask Dan Kearney to respond to that?

Senator HEINZ. Yes.

Mr. KEARNEY. Senator, if I might, one of the aspects of the strategic plan that bears on the answer to your question is, how have the bidding processes been revised in order to resolve these thrifts?

Senator HEINZ. Well, why is that relevant to a liquidation?

Mr. KEARNEY. Because what we have done is set up a process where bidders can bid as whole banks, as clean banks, against the cost of liquidation. And in fact, if they bid higher than the cost of liquidation, then——

Senate HEINZ. Well, what that tells me, with all due respect, Mr. Kearney—and I understand you are the Chief Executive Officer of the RTC Oversight Board—is that we want bidders to tell us which are the candidates for liquidation, and which are not.

I would think that an agency with the skills of the FDIC and the OTS ought to be able to make a pretty darned good cut, after we have had Federal deposit insurance for 50 or 60 years, to tell who is a candidate for liquidation and who is not.

I am not very persuaded by that, but I could be wrong.

Mr. KEARNEY. Well, I think that one of the points here is that the market could well put a different premium on the institution than the staff of the FDIC. And in fact, that has happened in some situations.

Senator HEINZ. Do any of you disagree with my pendent conclusion, that once you know the thrift should be liquidated, has to be liquidated—cannot sell it, cannot do a clean bank deal—that it is necessarily a lengthy and complicated process in order to do a liquidation? My understanding, as I said earlier, is that liquidations, once you decided to do one, were pretty quick.

Mr. KEARNEY. Yes.

Senator HEINZ. That is true; isn't it?

Mr. KEARNEY. Yes.

Senator HEINZ. OK. Let me turn to the next question, which is the issue I raised in my opening statement about how investors clearly want to buy a business that is going to earn, not burn, money.

The issue there, it seems to me, is a question of attracting capital. And it seems to me—and I say to all members of the Board—that it should go without saying that investors are not going to be willing to buy an S&L unless they can get a decent return for their money. I mean, why should you make an investment that is going to return you 2 percent? You can make more than that in index arbitrage, I guess. A lot of people seem to be doing so.

Many of the bids so far suggest that a thrift's deposit liabilities are worth more than its assets. How would you all assess the value of a thrift charter? Did the savings and loan bill make thrifts less attractive as an investment? If so, how can the charter be improved, while maintaining protection of the Federal Deposit Insurance System? How can we make these more valuable assets? How can they earn more money, without causing a problem for Bill Seidman, and the FDIC?

Are there any views on that? Is that a question that the Board has addressed? Mr. Robson? Mr. Kearney?

Mr. ROBSON. I guess I would say first that the regulatory future of the thrift industry was one that was scrutinized with extreme care during the development of the FIRREA bill. It was the judgment of——

Senator HEINZ. Well, I was a conferee, and I will talk about that in a moment. But how about you? How about the Board?

Mr. ROBSON. I think that that bill—and I am speaking for John Robson—I think that the bill struck a balance between protecting the future of the depositors and improving the long-term health of that industry, that was appropriate.

Senator HEINZ. Mr. Chairman, I see my time has expired. Do I have time for a comment?

The CHAIRMAN. Please, yes.

Senator HEINZ. I hope that there will be a second round, because I have got a couple of other important questions for this group.

The CHAIRMAN. There will be.

Senator HEINZ. One of the things that Congress insisted on which I thought it was too restrictive, was an excessively tight qualified thrift lending test. The one we ended up with is a 70 percent, very tight test, that only includes whole mortgages, mortgage backed securities, and loans for residential construction, in the main, that are qualified under that 70 percent test.

This tight QTL test was adopted because there was a view, strongly held by many Members of the Congress, that thrifts should only do mortgage type related, housing type related, lending. Thrifts were squeezed down to 30 percent doing everything else, under a very tight regime for the other 30 percent.

All the witnesses, however, that we have—whether it was from the FDIC, or from other skilled regulators—said that there is no increase in risk if you permit a larger proportion of consumer and/or education loans--that is usually in one category—or, although the banks would not like it, commercial loans.

Now, we ignored that advice, and drew a very tight lending test, so that the thrifts all have to put their money into the same market. What the laws of economics tell you is that that makes the market maybe too competitive, maybe it is just not an interesting market for new people to want to invest in.

And that is the thrust of my question.

Mr. ROBSON. It is a good question, and I did not focus specifically on the QTL issue. But if my memory serves me correctly, the

Treasury Department was for a little more flexibility in that, as I remember——

Senator HEINZ. That is right.

Mr. ROBSON [continuing]. When FIRREA was being pulled together. And it may be that the restrictions on that are indeed a burden on attracting buyers. I do not know that we know that yet. But I would guess that you could make an intuitive judgment that, to the extent that you have a very rigid constraint, you probably at the margin at least deflect some people who might otherwise be interested.

Senator HEINZ. The reason I bring it up—and I promised the Chairman I will just make a short comment, and I am not a man of my word today, sorry, Mr. Chairman—is that in a well-meaning effort to help the home buyer, what we appear to have done is to have made it unprofitable for lots of people to operate thrifts, or for thrifts to attract capital.

That is no service to the home buyer, if they cannot find the local neighborhood thrift because they are not there any more, because they have been put out of business or have been liquidated.

At the same time, guess what is happening to the taxpayer? The taxpayer is being stuck—if I am right—with an unnecessarily high cost, because it is always a lot more expensive to liquidate than it is to find a buyer. A buyer puts up money, it has got to be cheaper.

So it is a critical question. And I am giving you my instinct on it. I have not done any analysis, and that is why I hoped the Oversight Board—you are the policy-setting people—will do so as a matter of urgent priority.

You know, maybe we got it wrong. If we did, we are going to hurt the home buyer and the taxpayer.

The CHAIRMAN. Senator Bryan.

Senator BRYAN. Thank you very much, Mr. Chairman.

My question is one of policy. Earlier during the course of the hearing, the Chairman displayed the compendium of individual properties that are in the inventory, the many thousands of properties.

And the first question that I have is, is an individual buyer out there in the general public, can he or she or an institution turn to those tables and say, "There are a half-a-dozen properties that I like in Houston, a few in Denver that I think I want to buy"? Are those properties available for individual sale? Or, does a prospective buyer have to take the whole package, the good or the bad that might be in that particular institution's portfolio?

Mr. ROBSON. Dan, do you want to answer that?

Mr. KEARNEY. They are available individually, Senator.

Senator BRYAN. Fine. So in other words, if somebody sees something out there—maybe, give me some indication. How much activity do you have? How many inquiries, if you can generalize or put this in some perspective, do you get of people that are contacting and saying, "Look, I want to make a proposal on a particular piece of property"?

Mr. KEARNEY. I am sure Chairman Seidman will address that in his remarks, but before the publication of that inventory, there were something like 22,000 inquiries for the documents. And I think they have had something like 100,000 subsequent to the publication of the inventory.

Senator **Bryan**. Of the 42 resolutions that have been handled, can you give me the timeframe, the shortest time period, to resolve? What is the average time? And do you see that changing in the future? Whoever can answer that.

Mr. **Kearney**. I do not know if I have the shortest. Obviously, when we took—when the law was passed on August 9, there were some 280 institutions that were immediately put into the RTC's control. And as Senator Heinz alluded to in his remarks, we have prioritized those institutions, based on the ones that are suffering the most losses.

I guess I would be surprised if anything has been done in less than 60 days. But again, Chairman Seidman I think could probably answer that question.

Senator **Bryan**. Do you see that time perspective continuing prospectively?

Mr. **Kearney**. Well, I think, as Secretary Robson said in his remarks, we in the RTC see the pace of resolutions picking up considerably, once the working capital issue is resolved. We estimate that a rate of about 50 institutions a quarter, or 200 for this calendar year, is possible.

Senator **Bryan**. Another question I have, the REFCORP bond offering. The yield was much higher, I believe it averaged something like 8.6 percent. That is considerably above what was originally projected.

And I guess it raises in my own mind, as it has in the minds of several other members of the committee during the course of last year's hearing, as well as some of the aftermath, as we discussed, wouldn't it make a lot more sense, rather than going through this convoluted, indirect process, to have a direct Treasury offering in which the yields would be substantially less, and save the taxpayers a great deal more money? If indeed this trend is 8.6, if I have got that number correctly, and I believe that is about what it averaged, if that continues, it looks to me like those costs would be far greater than were originally projected.

I would invite your comment, Mr. Robson, on that.

Mr. **Robson**. I will leave the projection of future interest rates to the gentleman to my left. But I think the appropriate benchmark, Senator Bryan, is with previous REFCORP bond issuances. The 40-year bonds were in fact 11 or 12 basis points lower and, thus, less costly to the Government than the 30-year REFCORP bonds issued last year.

The spread between the REFCORP bonds and Treasury bonds was, if I remember correctly, about 24 basis points. I believe that was expected and was within the expected range when the issue of selling REFCORP bonds was discussed with Congress last year.

Obviously, you may not agree and say, "I think REFCORP is a lousy idea, and we ought to do away with it altogether." But I do think that the expectations and the reality have been relatively close.

Senator **Bryan**. Mr. Robson, you are putting a little different spin on it than at least the commentators that I have read. I mean, the impression that one gets, when you read the financial journals, is that it was very soft, that the rate was much higher than was contemplated. And it may be too dramatic to say that it sent some shock waves, but it certainly sent some ripples throughout the bond market.

Now, do I fail to read that accurately?

Mr. ROBSON. I think the REFCORP bonds were marketed at a time when the general bond market was under some pressure. I think the people that have complained the loudest are the ones who guessed wrong about what the interest rate was ultimately going to be on those bonds.

I do not think that the bond issuance should be characterized as a failure. I think it was a decent issue in a tough market.

Senator BRYAN. Well, not to be contentious, I have a recollection that we were told a year ago that the projection was to be, I think initially, at about 8.25, and that it would decline to about 7.25. That was what was originally talked about. That certainly—those numbers do not seem to be moving in that direction, if indeed my recollection is correct, Mr. Robson. The yields are much higher than that.

Mr. ROBSON. I do not know to what you are referring. If you would like, we would be happy to submit an answer for the record on that point.

Senator BRYAN. And if I might just follow up——

The CHAIRMAN. Please. If I may, I want you to continue. I think it is important, before we leave today, on this subject, not necessarily at this point, but I think it is very important that we hear from Chairman Greenspan on the market reaction to that REFCORP bond auction.

Senator BRYAN. Thank you, Mr. Chairman.

I appreciate it. If I might relay the Chairman's question to you, and get your response?

Mr. GREENSPAN. Yes. I think the problem was that the market misjudged in evaluating how a 40-year maturity issue would sell, as Secretary Robson has said. On when-issued basis, which was the market's endeavor to judge how a 40-year maturity would sell—because we have no 40-year maturities in the market—the early estimates were, as I recall, 10 to 15 basis points lower.

And as it turned out, the market misjudged on that. And it did create as an aftermath a significant reaction to the total U.S. Treasury market. And it was given as a reason for a significant weakening in the market.

But I think it is important to remember that, in making a judgement about what that issue would sell at, Treasury analysts had to project from a known base, that is, a 30-year issue, and try to make a judgment as to whether or not the yield from the 30-year issue would come down or edge up. And in that respect, both I think analysts within the Treasury and elsewhere, as well as in the private sector, were assuming a demand for that issue stronger than actually materialized in the auction.

Senator BRYAN. Do you think this was just an aberration that, now that we at least have some track record, such as it is, we are going to be a bit more accurate, and the market wil not misjudge, to use your term?

Mr. GREENSPAN. Well, I would certainly say that if another 40-year issue were put on the market—and I do not know that that is in fact the case—clearly, we would have a base now from which to operate.

But to the extent that other issues would be offered at differing maturities, we have a yield curve now which extends out quite substantially with certain adjustments between, say, REFCORP and U.S. Treasury issues required, which I suspect would enable a much closer judgment to be made, because we are not trying to project beyond the base of our data as was required in the 40-year maturity issue.

Senator BRYAN. Mr. Chairman, I thank you, and apologize for going over my time.

The CHAIRMAN. Not at all. In keeping with the practice of going back and forth across the table, we will go in the following order: Senator Mack is, in the order of things, next, in terms of going back and forth and then Senator Sarbanes, and then Senator Kerry.

Senator Mack.

Senator MACK. Thank you, Mr. Chairman.

Mr. Robson, or the other panel members can react as well. I want to focus in on the working capital question again.

As I understand from earlier comments, the preferred method of arranging for the working capital will be through borrowing through the Federal Financing Bank, or at least that is what I thought I heard anyway. I am wondering what the mechanism is there.

Are these loans—and the implication was, these loans would be secured by some assets, and there is a limitation of 85 percent of value. What I am getting at is, I am a little bit concerned about that 85 percent, in the sense of potential volatility in real estate markets, especially in the areas in which you are going to have accumulated these assets.

The bottom line is that if, A, we are wrong about the value initially, B, the market reacts to assets coming on to the market, further reducing the value of those assets, the ultimate impact is a loss in the working capital. In other words, the working capital is for the purpose, short term, to facilitate transfer of assets. There should be no budgetary impact. However, if the amount borrowed, secured by these assets, turns out to be insufficient to cover the borrowing, there is going to be an impact on the deficit.

I really would like to get your response to that. A, I guess really the question is: Do you intend to borrow up to the 85 percent of value? And, do you agree with me, B, that maybe that limitation ought to be reduced?

Mr. ROBSON. Let me say, first, that the available empirical data—and Mr. Seidman can speak further on this—shows I think that the FDIC has had about a 90-percent record of recovery of the appraised value of the assets in defunct institutions that it has managed.

Senator MACK. I assume that is the reappraised value.

Mr. ROBSON. Yes. Obviously, a basic protection in this is the soundness of your reappraisal at the time that you mark to market the assets that you are borrowing against. And I think that is a critical point.

So we feel as though there is a protection in the system that would allow us to go forward and make those borrowings.

If, ultimately, the assets against which there is borrowing prove to be—and of course, you may get more than you expect in some cases, too—less than the liabilities which have to be discharged, what you are really looking at then is a larger ultimate cost for the resolution of the whole problem. And that is really something different.

The working capital is a mechanism by which we think we can facilitate the process of resolution, and a necessary one.

Mr. GREENSPAN. Yes, Mr. Chairman, if I may just add to this question, I think it is important to distinguish between ultimate cost loss and working capital. I think that the system is constructed so that, by definition, working capital has zero loss at all times; in the sense that, if there is a certain amount of money put in to resolve a situation, and you get out less than you expect, all of that difference is charged as a loss, and is included in the $50 billion number.

It is important to recognize that we do not have two potential pockets of loss here; there is only one. And there will be, by definition, no loss on any working capital. It is merely a mechanism by which one temporarily finances warehoused assets. And any misestimate of the value of those assets does not get charged against the working capital; it gets charged against the ultimate cost.

All of the moneys that are involved in working capital will be repaid to the Treasury, and they will be repaid either directly from the funds that originally went out, or out of the $50 billion pool, which then gets moved into the working capital, to make it whole.

There is only one source of loss in this type of calculation.

Senator MACK. Good point.

Let me move to another area. Someone touched on it in their opening statement, which basically was, is there anything in the law that we passed last year that is having a negative impact either on the value of institutions, or in their viability?

I guess one thought that does come to my mind—and I do not know whether this really fits in it or not, but maybe we can use it as an example—there was a limitation on the amount of money that could be loaned to one individual, or one entity, which I have heard a fair amount about. But are there other things that we did last year that have had a negative impact on institutions around the country?

Mr. KEARNEY. Senator Mack, while you were out of the room I believe we did talk about the question of the charter with Senator Heinz. But the most important element of the law that has impacted the RTC operations is the loan to one borrower requirement.

We have a perversity here, that once a loan is delinquent in a conservatorship, the present interpretation of the rules would seem to indicate that a renegotiated loan is a new loan, and therefore is subject to the loan-to-one-borrower requirement, which would limit us to $500,000. And that obviously, with loans that are in excess of $500,000, is not possible.

The RTC general counsel, ourselves, and the Office of the Controller of the Currency, are working to revise or to eliminate that problem, as it applies to RTC conservatorships. You still have the issue as it relates to nonconservatorship institutions.

Mr. KEMP. Could I just add that, having just come from the Home Builders Convention in Atlanta, there is a lot of concern that, as was mentioned by Dan, the loan-to-one-borrower provisions, as well as the risk based captial provisions, are causing some unintended consequences, perhaps even indeed counterproductive, as more and more lenders are becoming reluctant to make real estate loans, particularly for AD&C type loans.

And I do not think it was the purpose of FIRREA to shut down the construction of housing or development of real estate. And I do not mean anything by that statement other than to suggest that some real thought has to be given across the board as to what we are going to do to make sure that FIRREA's requirements are met, while at the same time providing for an orderly transition and a length of time, so that we can make sure that proper and prudent and profitable AD&C loans can be made for the end purpose, which is of course to develop housing and to encourage homeownership.

Mr. ROBSON. Could I just say that several of you Senators have made the very good point that maybe we did not get it 100 percent right the first time. You, and Senator Heinz, and Senator Garn, and the Chairman.

It is good for us to be pushed, and certainly to the extent that we find things that are impeding the progress of resolutions, it is not in our interest to hide them. You have our assurance that we will be up here telling you about them.

The CHAIRMAN. Can it be very brief? I am sensitive to the others who are waiting in line here and are under time pressure, too.

Senator Sarbanes.

Senator SARBANES. Thank you, Mr. Chairman.

Gentlemen, how often does the Oversight Board meet?

Mr. ROBSON. We have had five meetings.

Mr. KEARNEY. Plus conference calls.

Senator SARBANES. I gather, under the statute, all of you have to be present currently in order to do business. Is that correct?

Mr. ROBSON. The bylaws provide procedures for the conduct of meetings, or for a conference call we all be present.

Senator SARBANES. But you have to have three to have a quorum, right?

Mr. ROBSON. That is correct.

Senator SARBANES. Now, I am interested in those two empty chairs over there, right at the end of the table. And really, every time I have been looking at the members of the Board that are here, my gaze has been diverted over to those two empty chairs, for the independent members of the Board.

Now, this legislation was signed on August 9. That is about 1 week shy of 6—6 months ago. Six months ago. And why have those chairs not been filled?

I mean, if we are serious about this business, it seems to me that one of the very first things that would have happened is, you would have put the Board into place. And here we are, 6 months later, we are still operating with the three, in a sense, ex officio members of the Board, all of whom have other pressing responsibilities.

These two independent members, who were to be appointed by the President, with the advice and consent of the Senate, what has happened? Where are they?

Mr. ROBSON. We expect to have the name of one independent member announced this week. It would have been my first choice, Senator Sarbanes, to be sitting here with those two individuals on either side of us.

We have had some difficulties in the clearance and selection process. Frankly, one of the problems is that people who know something about this business end up with either something they own or some aspect of their business life—because these are only part-time Board members—that presents a problem. And we have gone down some paths with some individuals, and had to give up on them for that reason.

Nonetheless, I share with you the importance of naming the two board members. We have been trying. We are very close to announcing one member, and we will name the other as quickly as we can.

Senator SARBANES. When you say "we," who is the responsible party?

Mr. ROBSON. These are Presidential appointees.

Senator SARBANES. And where has the hold-up been?

Mr. ROBSON. Well, the recruiting process has sometimes gone more slowly than we would have liked. The clearance process is a draconian one these days, having just been through it.

Senator SARBANES. Well, now what about an inspector general? Do you have an inspector general yet?

Mr. ROBSON. That individual has been identified and is in the clearance process.

Senator SARBANES. What does that mean?

Mr. ROBSON. FBI checks, the conflict of interest checks——

Senator SARBANES. Don't you think it is important for us to have an inspector general on-board quickly?

Mr. ROBSON. Yes.

Senator SARBANES. I want to ask about the Federal Housing Finance Board. Now, that is a five-member Board, that is to be a five-member Board; is that correct?

Mr. KEMP. That is correct, Senator.

Senator SARBANES. How many members of that Board are there, at the moment?

Mr. KEMP. Well, I am the Chair. At the moment, I have sent to the White House for consideration for an appointment the name of Mary Bush, the former Vice President for International Finance at Fannie Mae. And I would imagine that those decisions over the rest of the Board members will be made very soon.

I do not want anyone to underestimate the length of time it takes to find men and women who are willing to put themselves through the quite vigorous standards which are, as John Robson pointed out, quite vigorous, as they should be. But I am confident that you would be pleased to know that the Board is functioning.

We are in constant contact with the RTC. And we have been meeting with community-based organizations on a continuing basis, from the Consumer's Union, to ACORN, to LISC, to Enterprise Foundation, the National League of Cities, the Association of State Housing Agencies, to ensure that those affordable housing, low- and moderate-income needs are met.

Senator SARBANES. Well, thus far——

Mr. KEMP. It has taken time. And you can just be assured that we are going to move with dispatch to get these vacancies filled.

Senator SARBANES. Well now, one of the four directors is to come from organizations with a history of representing consumer community interests; correct?

Mr. KEMP. That is correct.

Senator SARBANES. What is the delay in finding that person?

Mr. KEMP. You are asking——

Senator SARBANES. Well, whoever is responsible. Are you the responsible party for finding the members of this Board?

Mr. KEMP. I am responsible—no, I am not—in terms of the Feeral Housing Finance Board, I am repsonsible for working with the administration to come up with what is called the consumer——

Senator SARBANES. Well, who is the responsible party that has not, in my judgment, not discharged their responsibility, so that we now are in the situation where we have the two independent members of the Oversight Board who have not been appointed, the inspector general—have not nominated—the inspector general has not been nominated, the four members of the Federal Housing Finance Board have not been nominated?

Are you the responsible party, Mr. Robson? Who is the responsible party for all of this? Is it the President, himself?

Mr. ROBSON. Well, ultimately——

Senator SARBANES. Shall we put it at the President's door step?

Mr. ROBSON. I do not know if that is terribly useful. These are Presidential appointments, and ultimately it is the President who makes the selection and sends up the nomination.

Senator SARBANES. But I assume someone is doing it for him. Who is——

Mr. ROBSON. Different departments usually have a role in the recruiting process. Then the White House Office of Personnel takes over and does the clearance.

So it is a process where one agency normally has a lead role in recruiting, although not necessarily the exclusive one.

Senator SARBANES. Well, it seems to me that the urgency that was attached to passing this legislation seems to have just evaporated upon its enactment. I mean, here we were told we were in a crisis, and so we put this legislation into place, we put this structure together. And then, these positions are not being filled.

Here we are, 6 months later, after the signing of the bill, 6 months, and these positions, very important positions—I have been looking at the statute and the responsibilities of the Board, both of these boards, and the responsibilities are quite extensive. And here we are with this Oversight Board, and you do not have either of the independent members.

They are not even before the committee. I mean, we do not even have them to start considering the people, to see whether they would be approved. I hope, when they get here, they are people of undoubted quality, so that we then do not have a problem on their confirmation. But they are not even here yet.

And we are here this morning talking about, are we going to need more than $50 billion, and how much more than $50 billion, and the response there is, "Well, this is segmented. We may have enough for this segment, but we do not know about the next segment."

But it seems to me that the minimum we should be doing is putting the team into place that the statute provides for, in order to address this problem.

Thank you very much, Mr. Chairman.

The **Chairman**. I would just say, in calling on Senator Kerry, that last year we moved I think as fast as any major piece of legislation of this scale and scope has ever come through the Senate. This here in the Senate took us 59 days, from the time that it was introduced to the time that it passed the Senate. And it was passed on an agreeable basis, bipartisan, with the administration, and so forth. And it was pretty much a day-and-night operation during that time, in order to try to get ahead of the problem.

And so I think many of us share the frustration that has been expressed by Senator Sarbanes and others, and that is, we really want to get the full team on the field. And I say again to you that, what we will do, as soon as we have nominations for these vacancies that have been enumerated, we will handle that as a top priority here, in terms of having the confirmation hearings and trying to move them into place.

I mean, we obviously have to take a look at them, too; but we will move just as rapidly as we can. But we cannot help you until you give us a nomination.

Senator **Sarbanes**. Mr. Chairman, could I add on that point, it seems to me, with 6 months having elapsed, that the administration ought to be able to put before us the full roster when they send the nominations, so that we are able to see in total what the composition of these boards will be, and not send them in here one at a time so we do not know what the entire board is going to look like.

Now, if you had come in here 1 month or 2 months after the bill and said, "Well, we have found this person, but we have not found the rest, we want to try to move it," I would have understood that. But it has gone so long now, that it seems to me that there ought to be some sense on the part of the administration of presenting this. I mean, we ought to see who the two independent members are going to be, and what that will do to the Board, and who the four members are going to be, including the consumer member——

Mr. **Kemp**. Right.

Senator **Sarbanes** [continuing]. With respect to the Housing Finance Board.

Mr. **Kemp**. Well, it needs to be said, Senator ~~Riegle,~~ Mr. Chairman. The Senator from Maryland is making a legitimate point. But there needs to be some perspective.

I sent up—the President sent up, actually—the nomination of the president of Ginnie Mae, which oversees about $400 billion of mortgage insurance. I would appreciate some help in getting Arthur Hill confirmed.

But I have been working with the Chairman, and I respect the process enough to suggest that we are functioning, both in the Oversight Board as well as at the Federal Housing Finance Board, and Arthur Hill is functioning at Ginnie Mae.

But it was a long and cumbersome process to put that team in place, and we at HUD think we have got a good team in place. It took an awfully long time. And I am very pleased with the cooperation that I have received, not only in that process, but also in our reform package.

But I do not want to let this meeting go by, and I would say to my friend from Maryland that this is a very difficult and time consuming process. But I do not want anyone to think that we are not functioning in that Federal Housing Finance Board, and working with the type of consumer groups on the issues, Senator, that you have given us, both at HUD and at the Federal Housing Finance Board, and at the RTC Oversight Board, to see that mission through.

Senator **Sarbanes**. Well, I understand that, Mr. Secretary. But your functioning as a one-man board in a Board that is supposed to have five members. And it seems to me that you have an awful lot of responsibilities on your shoulders. And to in effect make you the sole person——

Mr. **Kemp**. Right.

Senator **Sarbanes** [continuing]. On a five-member Board, it does not seem to me is addressing that situation.

I did not press Mr. Robson or the Oversight Board, but I will at this moment. The statute requires you to establish a national advisory board and regional advisory boards. Has anything been done in that regard?

Mr. **Robson**. Yes. We have identified the chair people of those boards and the chairperson of the national board. They are now in the clearance process.

Senator **Garn**. Mr. Chairman, if I could just respond to one point, so that there is not confusion.

I do not disagree with Senator Sarbanes at all. I think I have made myself abundantly clear on the need for speed in all of these areas. I do not need to repeat that.

However, Mr. Robson asked me yesterday—contrary to your advice to wait for everybody—he said, "We have one that is ready to be sent up and intend to nominate. And should we wait until we get all the others?" And I said, "For heaven sakes, no. After 6 months, when you get somebody through the process and identified, send them up."

So I want it on the record that, get them in place as rapidly as you can. And so that you are not confused by one Senator, you know that everybody knows you have received different advice from two different Senators, one to wait for all of them, and my statement to, as yesterday privately and today publicly, when you get them on all of these send them up. If it's in the middle of the night, let's get on with it.

Senator **Sarbanes**. Well, now I am not telling him not to send them up. I am simply saying that 6 months after the fact, they ought to be able to send them all in here, so we can take a look at what these boards are going to look like. I think it is really——

Senator **Garn**. Well, you might wait another 2 or 3 months. That is the problem.

Senator **Sarbanes**. Well, I think it is a dereliction, frankly, that this issue has to be raised, that we are here 6 months after the bill was signed without those two seats filled on the Oversight Board and with the other problems that we have.

The **Chairman**. We have got two more members that have been at the Budget Committee hearings this morning where Mr. Darman has been presenting the budget, and otherwise were required to be there.

I am going to call first on Senator Kerry. There will be a couple of additional questions that I know some of us want to ask. And in due course I am going to ask Mr. Seidman—in fact, now, Mr. Seidman, why don't you come on up and take the seat at the end.

This does not put you on the Oversight Board——[laughter.]

But why don't you—we are running long here, because there is intense interest in participation. But I think there are a couple of questions that we need to cross-connect on at some point. So if I could ask you to take that seat.

Senator Kerry.

Senator **Kerry**. Thank you very much, Mr. Chairman.

Do I understand that Mr. Seidman's presence at the table allows us to now ask questions?

The **Chairman**. Well, I think if there is something that requires sort of cross-connecting here, by all means, yes.

Senator **Kerry**. I might just do that.

Let me just ask, if I can, I really do not have many questions, because I think most of them have already been asked today, and I am at the tail-end here. But a quick question I would like to ask is, with respect to the ethical standards, the $50,000 substantial loss definition that has been applied, some folks have suggested to me that that may be overly restrictive, and deny the use of some people who lost, say, a personal home or something as a result of the downturn, but whose skills may be valuable nevertheless.

Is there any thought about that? Why was the $50,000 chosen? And do you worry about losing those people, or does it not matter?

Mr. **Kearney**. Senator Kerry, the draft regulations do call for a $50,000 limit with respect to losses caused to the insurance fund. We at the Oversight Board and the RTC, as well as the ethical officers of the various constituent agencies, debated this issue at some length.

There was a lot of debate. Some people thought a number as low as $5,000, and some thought a number as high as $100,000 was the appropriate one. We struck on $50,000.

There are a lot of comments on that issue that we are presently in the process of assessing before the final rates go up. It could be that someone who is otherwise qualified would be precluded by that test. But on the other hand, there are a lot of people who are not qualified who would be precluded by that test.

Senator KERRY. You are not concerned about the loss? I mean, you feel——

Mr. KEARNEY. I think it is an appropriate number, given the balances at this time.

Senator KERRY. You do not think it needs capacity to review on an individual basis the circumstances? I mean, I am just concerned that the amount of asset you are going to try to dispose of in the kind of time period you are talking about, and the savings that might be represented as a result of the speed being applied to the process, coupled with experience, obviously, that it could be of benefit to the process. That is all.

Mr. KEARNEY. Obviously, if it were a constraint, we would change it.

Senator KERRY. A second question. There are some of us who opposed some of the changes back in 1986 that were aimed, we thought, too directly and in a punitive fashion at the real estate industry itself. Has any thought been given, any analysis, to whether or not some tax change, some modified passive investment rule, some reinvigoration of that market through perhaps the tax structure, might in effect be cheaper in the long run to the Government, and save a considerable amount of administrative expense and oversight by letting—or by reinvigorating the market, so that the market can in effect do much of this for us.

Would that be cheaper? And has that analysis been made, or is that—Mr. Secretary, do you have any thoughts on that?

Mr. KEMP. I think I will let Secretary Robson discuss the tax consequences.

Mr. ROBSON. I do not recall that an anlaysis was made regarding ways to make thrift acquisitions more appealing because of some tax——

Senator KERRY. No, I am not thinking of the thrift, per se. I am thinking of the assets. I am thinking particularly of the real estate.

Mr. ROBSON. Yes. I would say this. With respect to the passive loss provisions of the Internal Revenue Code, I do not think there is any consideration of changing them. But I cannot tell you that the analysis that you suggest has been done.

Senator KERRY. Well, if it were cheaper, would it not make sense?

Mr. ROBSON. It could.

Senator KERRY. Why would we not make that kind of analysis? I mean, wouldn't the spin-off, in terms of the rest of the economic activity, be relatively significant?

Mr. GREENSPAN. If I may, Senator, the type of calculation you are asking to be done is a very subtle one. And we do not know at this stage—and I do not think we knew, at the time of the 1986 Tax Reform Act—precisely what the shift in views toward passive investment in real estate would do, and in fact has done, to real estate values.

It is an extremely tough calculation. And because it is so difficult, I am not sure we would be able, even with very significant analytical resources, to come to a conclusion which you would be comfortable with. There is just too much uncertainty.

We are dealing with an extraordinarily huge market, with very significant regional differences. There is no question that the effect of the new tax law on values was negative. You can see it in the extent of syndications and partnerships, and a variety of other issues. But I would defy anyone to come up with a number that anyone who was involved would feel comfortable with.

Senator **KERRY**. And that, Mr. Greenspan, is notwithstanding the capacity we had at the time to measure fairly accurately the revenue we were going to gain by virtue of the change.

I mean, at the time, I remember people say, "If you do this, there is going to be 'X' savings to the Government."

Mr. **GREENSPAN**. No, I think that is correct, I think——

Senator **KERRY**. Why can't you do that in reverse?

Mr. **GREENSPAN**. Well, basically because there is a more difficult problem here in trying to make a judgment as to what would happen to the market value of assets. Whereas, I do not think that judgment had to be made in calculation of the tax savings involved in the change in the law.

Senator **KERRY**. Well, I would like maybe to pursue that with you some other time.

STATEMENT OF L. WILLIAM SEIDMAN, CHAIRMAN, RESOLUTION TRUST CORPORATION; CHAIRMAN, FEDERAL DEPOSIT INSURANCE CORPORATION

Mr. **SEIDMAN**. Good morning, Mr. Chairman and members of the committee. I am pleased that you called this hearing today so I might testify on the financial status and activities of the Resolution Trust Corporation and share with you our views on the Strategic Plan.

I would like to begin my testimony with a quote from the wisest man who ever lived, King Solomon. The good King said, and I quote, "He who is *surety* for a *stranger* will surely *suffer for it, but he who hates going surety is safe*." End quote. (Proverbs 11:15)

I am here to testify to the wisdom of Solomon. In fact, I have begun to think of the RTC as retribution in biblical proportions for indiscriminate suretyship—something on the order of swarms of locusts and fiery hail stones.

My purpose today is to respond to your request for information on how the RTC is doing. Despite reports to the contrary, I believe it is doing reasonably well.

Much has been accomplished in less than 6 months at the RTC even though we, of course, would like to have done more.

It has:

Developed a strategic plan with the RTC Oversight Board.

Established 4 regional offices and initiated the establishment of 14 consolidated offices.

Hired a staff of nearly 1,900 people accomplished while merging with the FSLIC.

Assumed management and institutional control of 349 thrifts in 37 States.

Downsized thrifts in conservatorship by about 20 percent.

Provided $9.2 billion in advances to 156 institutions to replace their high cost funds.

Provided $2.2 billion of emergency liquidity financing to 89 institutions.

Sold or liquidated 42 institutions in 17 States.

Initiated sale of an additional 64 institutions.

Inventoried over 30,000 real estate properties and published a listing of their key investment characteristics in a 4-volume, 100-page set.

Established and published conflict of interest guidelines.

Established marketing and open bidding process:

Prepared a guideline booklet, *How to Purchase an S&L from the RTC;* scheduled the RTC Seminar Series; established an 800 Hot Line; provided Sample Bid Packages; and published a Resolution Schedule.

Put RTC asset managerial guidelines in place.

Developed method for assigning priorities for scheduling restructure of institutions.

Established interim program to provide outreach to minority and women contractors.

Developed interim guidelines to promote low-income housing.

Assumed litigation responsibility for over 40,000 lawsuits.

Filed the largest depository institution fraud suit in history [the $1.1 billion suit against Charles Keating, et. al.].

As I indicated, some have criticized the RTC for moving too slowly. But, I believe the accomplishments I just listed are fairly impressive. Then again, I am far from impartial.

Part of this discussion has centered on the structure of the RTC and the Oversight Board. It is our view that the working relations between the RTC and the Oversight Board have been good as a result of outstanding efforts by Executive Director David C. Cooke and Oversight Board President Dan Kearney.

It is also evident that we have an unusual structure. There are two Boards involved—each of whose duties are provided by law. The need to deal with two Boards and their staff makes doing business more time consuming than if we were working in a more traditional structure. However, the structure provides more controls and policy checks than would be available in a more traditional organization. Given the unusual, precedent-setting job involved in cleaning up the S&L mess, such control and such a unique structure may be appropriate.

How effectively it will operate, is a question that should be examined over time. It is too early to make a judgment at this point.

I bring it up now only in answer to the "too slow" comments. The system in place will be, at least in the beginning, slower and more bureaucratic than a more normal structure with one Board and one organization. The system can be most effective if there is a clear understanding between the two entities that the Oversight Board sets broad policies and the RTC carries them out.

The strategic plan was written by the Oversight Board in close consultation with the RTC. The plan is a pure American document [as it should be]—a series of compromises and trade-offs. That process continues. This is to be expected since almost all of the key decisions involve tradeoffs between competing interests. The best known example perhaps, is the setting of policy which results in speedy sales of property, but which avoids "dumping" of assets.

The RTC currently is discussing with the Oversight Board ways to allow greater flexibility with respect to terms of sale of institutional assets. Our discussion raises a typical tradeoff question involving credit risk versus speed of sale.

Key among other strategic issues is our financial outlook—both with respect to the loss likely after the RTC finishes its work, and the financing or "working capital" needed in the interim.

In his testimony, Deputy Secretary of Treasury Robson has given a detailed explanation of the need for working capital. We support his presentation.

To summarize our views on the likely *size of the loss*—$50 billion as provided in FIRREA is probably to low a figure, but it is very difficult to provide any more definitive number at this time. I have provided a wide range of possibilities in my written testimony, so any observer can choose his own number. In any event, the $50 billion figure would appear to be sufficient to cover losses into 1991.

To summarize our views on *working capital*—it is needed *now* if the task is to proceed on schedule and if we are to minimize the cost to taxpayers. Our current estimate is that we will need between $45 to $55 billion during 1990 and additional amounts during 1991.

The method of financing working capital is not our responsibility so I will not be dealing with that issue today.

I have provided you with a summary of our financial needs, let me briefly fill in some details.

In a letter to Chairman Riegle last June, while FIRREA was still being debated, we addressed some of the same questions regarding the RTC's funding needs.

At that time, we identified 428 savings associations that as of year-end 1988, held $180 billion in gross assets and $178 billion in liabilities. These were institutions that we felt were likely to come to the RTC. Based on year-end 1988 data, and economic models used by the FDIC, we estimated the potential loss from these institutions to be about $44 billion.

We concluded that the $50 billion in capital provided to the RTC under FIRREA appeared to be a reasonable estimate. We did note that $50 billion didn't leave much of a comfort margin.

As of January 16, 1990, the RTC had resolved 40 institutions. It had 293 institutions under conservatorship. These 333 institutions held $136 billion in gross assets and $148 billion in liabilities as of September 30, 1989. Our estimate of the cost of resolving these institutions, based roughly on FDIC loss experience, is approximately $42 billion.

If the caseload does not grow more than another $40 to $50 billion in liabilities, the $50 billion funding provided by FIRREA would appear to be adequate.

Beyond those numbers, additional funding to absorb losses will likely be needed. The RTC relies on the Office of Thrift Supervision

[OTS] to identify institutions it expects may eventually come to the RTC.

A preliminary estimate given to the RTC by OTS on January 18, indicates that there are 225 to 295 institutions with $160 to $200 billion in assets above those already under RTC conservatorship that may be categorized as "likely to fail."

The preliminary estimate also identifies an additional 295 to 325 undercapitalized institutions with $185 to $205 billion in assets categorized as "distressed."

Based on FDIC's recent "backup" examinations of thrifts, we have found no reason to question the reasonableness of the OTS estimates on the number of "likely to fail" institutions. We have been told that OTS expects to resolve the "distressed" institutions without government assistance, but our examination process has not proceeded to the point where we can confirm that independently.

Obviously the variance in the number of institutions [and their assets] that may come to the RTC is wide and there is no way at this time to provide a definitive forecast of what the final number will be.

The estimated loss at institutions that recently have entered the conservatorship program is less than the estimated loss of the early entrants into the program [about 36 percent of gross assets]. Losses in institutions recently taken over by the RTC are estimated to be 20 percent of gross assets. We cannot at this time estimate loss for future RTC restructuring activities as this will be determined by the condition of the institutions and by future market conditions.

Under almost any scenario, the $50 billion capitalization provided by FIRREA should, as far as losses are concerned, carry the RTC into 1991.

The need for additional funds to absorb losses, if such a need develops, can be better assessed after OTS and the FDIC have done more examinations.

As I mentioned in my letter to Chairman Riegle, and many times since then, regardless of the size of the ultimate loss, the RTC needs additional financing—working capital—to fund resolutions efficiently and to reduce the cost of funding assets until they are sold.

The amount of working capital necessary in 1990 for both funding and resolutions depends on the status of the institutions to be sold during this period. Our current estimate is that our financing needs will be $45 to $50 billion. We may find that we will not have sufficient assets to borrow this entire amount due to the FIRREA lending restriction [85 percent approved value]. Something between 15 to 25 percent of the gross assets the RTC is eventually asked to handle would appear to be a pretty good estimate of working capital needs.

The potential savings to the taxpayer from high cost fund replacement for institutions currently under conservatorship is about $1 million a day, plus any savings from overall rate reductions.

Working capital is not intended as a means to finance a loss in excess of $50 billion. FIRREA restricts the amount of working capital the RTC can borrow, to 85 percent of the market value of RTC assets.

Of course, should the actual value of assets prove to be less than 85 percent of the estimated market value, it is possible the RTC will not be able to repay all its working capital borrowings from asset sales.

If this happens, working capital will have been used to fund a portion of the loss, but this is not what is expected or intended.

The RTC has developed interim guidelines to meet the eligible residential housing requirements of FIRREA. These guidelines have been forwarded to the Oversight Board for review and approval prior to beginning a demonstration program. A Program Director, Program Coordinator, and staff in regional offices are in place to implement the Affordable Housing Program.

Working with the National Governors Association, the RTC has contacted State Governors to confirm the designation of housing finance agencies as clearinghouses and to identify other housing agencies to support this program.

Governors and State housing finance agencies each received a copy of the inventory of affordable housing properties. The procedures for involving State housing agencies and national nonprofits are part of our interim guidelines.

The RTC has consulted with HUD, other Federal agencies, and secondary market entities to begin to identify and arrange for financing of eligible property sales. We have met with the Federal Housing Finance Board to enlist their cooperation in providing financing. Contacts have been established with national nonprofit organizations that will serve as clearinghouses and technical assistance advisors.

The RTC plans to begin marketing properties under the interim guidelines no later than the end of the month. So far, we have identified about 700 residential properties owned by RTC that appear to qualify for the Right of First Refusal Provisions of FIRREA.

While the number of properties is small in size, it does provide a good basis for experimentation by RTC, the clearinghouses, and others.

By far, the vast majority of affordable housing is held by conservatorships. We have identified 10,000 properties—half of which are in Texas—that appear to meet the affordable housing criteria—and as new appraisals come in, the number will surely increase. We will follow the spirit of FIRREA in handling these units.

The magnitude of the RTC's potential costs mandates seeking new and more efficient ways to handle the problem. As I have indicated, a critical element in the cost structure contemplated by FIRREA is the number of institutions the RTC will be asked to handle. Reducing the number of institutions that come to the RTC may be one way to reduce costs. Such a solution would also lessen the potential flood of real estate to be sold in the marketplace.

In accordance with the strategic plan, the RTC staff has begun a study of new ways of dealing with open or conservatorship institutions. In this regard, we also are examining our previous experience with open banks transactions. There will be no cheap solutions, but we are looking for new and better ways to limit the cost of this unfortunate situation.

In conclusion, please be aware that almost all of this discussion has been an attempt to predict future events, and we have not yet perfected the crystal ball that is even 90 percent accurate in forecasting the future.

The only thing certain is that things will change. Our job is to meet the challenge of changing conditions.

Thank you.

[The prepared statement of L. William Seidman follows:]

SUMMARY OF TESTIMONY
L. William Seidman
Hearing on Status of the RTC
January 31, 1990

I. CURRENT FINANCIAL STATUS

The $50 billion funding provided by FIRREA should, as far as funding loss is concerned, carry the RTC into 1991. Future losses will depend on the number, size and financial condition of the savings associations RTC will eventually handle, together with such general factors as interest rates, future real estate prices and future economic conditions.

What cannot be delayed, however, is the need for working capital to efficiently handle resolutions. Working capital is needed to finance problem assets pending their eventual sale: the RTC's cash outlays occur up-front at the time of resolution, but its cash inflows occur over a number of years. Working capital is also necessary to replace high-cost funds at the institutions under RTC conservatorship. Replacement of these funds yield a tangible savings to these institutions, thereby reducing the ultimate cost of their resolution to the RTC and the nation's financial system.

II. STRATEGIC PLAN

Although the RTC has requested certain changes in the Oversight Board's Strategic Plan, we believe it is a good document that gives the RTC direction, among sometimes conflicting concerns, in major operational areas. The Plan sets goals and objectives, and relies on the RTC to develop the numerous written policies and procedures in accordance with established timeframes, as discussed briefly below.

Case Resolutions

The Strategic Plan requires the RTC to manage and resolve institutions within its jurisdiction in a timely and cost-effective manner, while minimizing the negative effects on local financial and real estate markets. In compliance with the Strategic Plan, the RTC has installed a Managing Agent and Credit Specialist in each conservatorship to ensure prudent thrift operations and institutional downsizing, as well as to detect or prevent (with investigative assistance) insider abuse. The RTC has also broadened the competitive bidding process for its resolutions, prioritized them based on Strategic Plan guidelines and introduced flexible bidding options now available for prospective purchasers. The RTC has further solicited the participation of the private sector wherever possible in its resolution efforts by retaining individuals and firms to perform many of its conservatorship functions, including the RTC's statutorily-required analysis of the 1988 FSLIC deals.

Asset Dispositions

The Strategic Plan requires the RTC to dispose of its real estate and other assets in a manner maximizing the RTC's net present value while also minimizing the effect of its asset dispositions on local real estate and financial markets. The RTC's disposition activities will cover a wide variety of activities (auctions, bulk sales, etc.) and rely heavily on participation by the private sector. The RTC will use appraisals to establish appropriate listing prices, expose the property to the widest appropriate market, and obtain the highest sales price for acquired property. In addition to its certification procedures for integrity of the contracting and bidding process, the RTC's asset disposition program will also feature, as required by FIRREA, an affordable housing program. This program will allow the public and private sectors to work together to make RTC assets available to low- and moderate-income individuals and families. As the recently-published Real Estate Asset Inventory demonstrates, all RTC property with marketable title is eligible for sale and has generated much interest among prospective purchasers.

Ethical and Conflict of Interest Guidelines

A three phase program to implement the ethical standards for independent contractors will include: qualifying for competence, experience, fitness and integrity; a solicitation process including certifications about conflicts of interest; and an award phase requiring compliance with the RTC's independent contractor regulations. We are currently drafting final regulations to complete this process.

Measures to Avoid Political Favoritism and Undue Influence

As required by the Strategic Plan, phone logs are being required of all communications between public officials or their staffs and RTC employees which are intended to influence a case specific decision. A draft policy for RTC employee interaction with public officials has been completed and the Committee's input is welcomed prior to finalization of the policy.

Corporate Administration and External Relations

The RTC's efforts to effectively manage its resources is reflected in its first quarter budget for 1990. In this budget, about $230 million was requested for operating expenses. While early estimates suggest that the RTC's operating budget for 1990 could approach $1.5 to $2.0 billion, we believe that a large percent of this budget will be for outside services, reflecting our goal to contract to the private sector at least 80 percent of the RTC's asset workload. This outside contracting will include the RTC's nationwide interim minority- and women's-outreach program. We have kept the public informed of our activities through publications, advertisements, "hotlines", seminars, and a soon to be established reading room.

III. OTHER ISSUES

The FDIC has also undertaken and reported on certain projects, some of which were required by FIRREA (e.g., liquidation of FADA) and others (e.g., the SAIF assessment base) which may be of general interest. The FDIC's liquidation of FADA will be completed shortly.

TESTIMONY OF

L. WILLIAM SEIDMAN
CHAIRMAN

RESOLUTION TRUST CORPORATION
WASHINGTON, D.C.

ON

STATUS OF THE RESOLUTION TRUST CORPORATION

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS
UNITED STATES SENATE

10:00 A.M.
January 31, 1990
Room 538
Dirksen Senate Office Building

Good morning, Mr. Chairman and members of the Committee. I am pleased to appear before you today to discuss the financial status and activities of the Resolution Trust Corporation (RTC), as well as to comment on the Strategic Plan that was adopted by the RTC Oversight Board (Oversight Board).

The RTC has existed less than six months, but already has accomplished much. Our testimony will acquaint you with those achievements. However, the greater part of our work lies ahead, and we will discuss with you how we hope to complete that work. The timely and efficient completion of our mandate depends on many factors. We will examine those factors we believe to be of particular importance, and how they may impact upon the RTC's operations.

You have heard from the RTC Oversight Board concerning the Strategic Plan. The RTC is moving forward quickly to implement the policies and programs mandated by the Oversight Board under the Plan.

I. CURRENT FINANCIAL STATUS

The RTC's funding needs will depend on a variety of factors such as future economic conditions, the future level of interest rates, and future real estate prices, all of which cannot be predicted with any degree of certainty. However, the critical factor is to predict the number, size and financial condition of the savings associations the RTC will eventually be called upon to handle.

In a letter to Chairman Riegle written last June (See Attachment 1), while the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA) was being debated, we addressed some of the same questions regarding the RTC's funding needs that we are being asked to testify upon today. At that time, we identified 428 savings associations that we felt were most likely to come to the RTC. Based on year-end 1988 financial data, and economic models used by the FDIC, we estimated that the potential loss from these institutions would be about $44 billion and that the $50 billion was a reasonable estimate of loss. We noted, however, that there was not much of a comfort margin.

As of January 16, 1990, the RTC had resolved 40 institutions and had 293 institutions under conservatorship. Collectively, these 333 institutions reported $136 billion in gross assets and $148 billion in liabilities as of September 30, 1989. (Note most of these institutions were the ones identified last June, although many are significantly smaller now after being shrunk while in conservatorship.) Our estimate of the present value cost of resolving these institutions, based on FDIC loss experience, is approximately $42 billion.

If the case load does not grow more than another 100 institutions or another $40 billion in liabilities, the $50 billion funding provided by FIRREA would appear to be adequate.

Beyond those numbers, additional funding to absorb losses will likely be needed. The RTC relies on the Office of Thrift Supervision (OTS) to identify institutions it expects may eventually come to the RTC. OTS has informed us that it is working on its most current list of problem thrifts, which it expects to give to the RTC in the next few weeks. A preliminary estimate given to the RTC by OTS on January 18, indicates that there are 225 to 295 institutions with $160 billion to $200 billion in assets above those already under RTC conservatorship that may be categorized as "likely failures." The preliminary estimate also identifies an additional 295 to 325 seriously undercapitalized institutions with $185 billion to $205 billion in assets that OTS expects to categorize as "distressed." Based on FDIC's recent "backup" examinations of thrifts, we have found no reason to question the reasonableness of the OTS estimates on the number of troubled institutions. We have been told that OTS expects to resolve the distressed institutions without government assistance, but our examination process has not proceeded to the point where we can confirm that independently. In summary, the information as of January 16, 1990 may be charted as follows:

	Number		Assets (Billions)	
	Low	High	Low	High
Likely to Fail	225	295	$160	$200
RTC (actual)	333	333	136	136
TOTALS	558	628	296	336
Distressed	295	325	185	205

NOTE: Asset figures for Likely to Fail category and Distressed category are net assets. Asset figures for RTC (actual) category are gross assets. OTS has not provided the RTC with gross asset estimates.

Obviously the variance in the number of institutions and their assets that may come to the RTC is wide and there is no way at this time to provide a definitive forecast of what it will be. The estimated loss at institutions that recently have entered the conservatorship program is less than the estimated loss of the early entrants into the program (which was about 36 percent of gross assets), so that the incremental loss of new institutions is expected to be less than the average loss. Losses in institutions recently taken over by the RTC are estimated to be 20 percent of gross assets. We cannot at this time estimate loss for future RTC restructuring activities as this will be determined by the condition of the institutions and market conditions at the time.

Under almost any scenario, the $50 billion provided by FIRREA should, as far as funding loss is concerned, carry the RTC into 1991. The need for additional funding, if any, to absorb losses can be addressed with much greater certainty at that time. What cannot be delayed, however, is the need for working capital.

Working Capital

As stated in the letter to Chairman Riegle, and many times since then, the RTC needs considerably more than $50 billion in the form of short term financing or working capital to most efficiently handle resolutions. First, working capital is necessary for resolutions in order to finance problem assets pending their eventual sale. RTC's cash outlays take place up-front at the time of resolution whereas its cash inflows -- whether from REFCORP or the sale of assets -- will take place over a number of years.

Second, working capital is necessary to replace high-cost funds at the savings associations under RTC conservatorship. Very high-cost funds (i.e., costing at least 125 basis points over market) currently represent roughly 20 percent of the liabilities of these associations. High-cost funds replacement would yield a tangible savings to the thrifts under RTC conservatorship, thereby reducing the ultimate cost of their resolution. Such a program applied on a nationwide scale would reduce the financing costs of all banks and thrifts, reducing the RTC's eventual case load and resulting in improved performance of the entire U.S. financial system.

Working capital for resolutions. Let us focus first on the working capital necessary to finance resolutions. The cash needed for a resolution is highly dependent on its structure. We expect that most of the resolutions will be very cash intensive "clean" thrift transactions, in which substantially all the illiquid and distressed assets are retained by the RTC.

The RTC and the Oversight Board are now considering a modification of the Strategic Plan that would allow more liberal asset put-back structures. Under the modification contemplated, it may be possible to transfer substantially more assets, at least initially, to the acquirer. This would require much less working capital up front and probably result in more assets eventually being transferred to the acquirer.

More flexibility in put-backs also could speed up the resolution process by shortening the due diligence period.

We estimate that for the 333 institutions resolved or under conservatorship as of January 16, 1990, working capital needs simply to fund resolutions should peak around $36 billion above the funds provided by FIRREA to cover losses, with the actual amount depending on the speed of resolutions and the rate of disposition of less liquid assets. The working capital estimate assumes that most resolutions will be "clean" transactions where only liquid, nondistressed assets are purchased by the acquirer. The estimate also assumes that institutions in conservatorships have been significantly downsized prior to resolution. Of course, the total amount of working capital that ultimately will be needed will depend upon the ultimate size of the case load. If the RTC's gross assets were to reach $300 billion, working capital needs just to fund resolutions could reach $70-$90 billion. Again, the actual amount will depend on the timing of when institutions enter conservatorship and the scheduling of resolutions.

Working capital for high-cost funds replacement. The second major need for working capital is for replacement of high-cost funds such as brokered insured deposits where the failed thrift must pay very high interest rates. Replacing high-cost funds affects the timing of the need for cash by the RTC. While working capital to fund resolutions is likely to reach its peak toward the end of the resolutions process, high-cost funds replacement, in order to be effective, must begin to take place as soon as a thrift enters conservatorship. Thus, high-cost funds replacement shifts the demand for such financing to the present.

The potential savings to the taxpayer from high-cost funds replacement is significant. We estimate that at the current conservatorships alone there is $20 billion in funds maturing over the next two quarters that cost at least 125 basis points over prevailing market rates. Replacing these funds and assuming an average savings of 150 basis points, the savings would be about $300 million per year. When one considers all other thrifts likely to come to the RTC, the savings from reducing high-cost funding would be very substantial. Moreover, even replacing just some high-cost funds should lower substantially the interest rates on all brokered deposits not only for existing or likely conservatorships but on all depository institutions.

Replacement of high-cost funding would go a long way toward stemming immediately the growth in losses of current conservatorships as well as RTC-bound thrifts. We have estimated roughly that conservatorships are experiencing combined operating losses approaching $14 million per day. These losses are caused by one or all of three factors: First, by the amount and cost that their liabilities exceed the fair value and yield in their assets (i.e., they are insolvent);

Second, to the extent they must pay significantly higher rates for their funding than healthier competitors; and Third, because they often have operating inefficiencies, to some extent because cost savings generally lag downsizing programs.

RTC analysis indicates that at least two-thirds of the growth in losses is attributable to the first factor, and thus unavoidable. That is, the loss now being funded in the institutions will have to be funded by the government after resolution. However, approximately 20 percent of the avoidable loss is due to the second factor and could be very rapidly eliminated through high-cost funds replacement.

Finding a source or sources of working capital is not a responsibility of the RTC, but comes under the purview of the RTC Oversight Board. We are told by the Oversight Board that they expect to be able to provide the RTC with working capital in the next four tc six weeks. These funds must be obtained promptly if the resolution process and replacement of high-cost funds are to proceed without interruption.

Current Sources and Uses of Funds

An outline of the RTC's actual cash inflows and outflows should illustrate the urgency of this problem. As shown in Attachment 2, by December 31, 1989 the RTC had received $24.5 billion in capital contributions. Of this amount, $20 billion was provided by Treasury appropriations or Federal Home Loan Bank contributions, and $4.5 billion was provided from the proceeds of the first quarterly REFCORP financing. The RTC's cash outlays totaled $20.2 billion, including $9.2 billion to resolve 37 thrift institutions, and $9.2 billion in advances for high-cost funds replacement at 156 institutions. Also included in the $20.2 billion total are 261 advances for emergency liquidity which we were forced to make to meet depositor demands at 85 conservatorships. The cash outlays for this purpose totaled $1.8 billion.

As a result of these cash outlays, the RTC at the end of 1989 had only $4.3 billion in cash. All of that amount had been set aside to cover the projected cost of resolving 12 institutions which had to be held over to 1990 due to extended due diligence requirements of the bidders. Through Friday, January 19, 1990 we had received no additional funds, but had spent an additional $1.3 billion. This left the RTC with a current net cash position of only $2.9 billion.

The second quarterly financing of REFCORP is about to provide another nearly $5 billion in funds. We also have the potential availability of an additional $5 billion from the Treasury line of credit granted to the RTC by FIRREA. This line is intended to be used only to satisfy the emergency liquidity needs of our conservatorships.

RTC's own operations are also a potential source of funds, but the cash available in the immediate future from our conservatorships and receiverships is quite limited. Specifically, if we were to force all of the conservatorships that have received advances from the RTC to repay whatever advances they could by divesting all of their cash and marketable securities, we would net less than $1 billion. Similarly, the maximum dividends expected to be payable from the RTC receiverships this quarter -- through the liquidation of their assets -- is estimated not to exceed $1 billion.

Until the working capital issue is resolved, the RTC has ceased virtually all advances to replace the high-cost funds of the conservatorships. As indicated earlier, this program has been successful in reducing the funding cost of conservatorships and, thus, limiting the growth of the loss that must be borne by the RTC.

New Approaches

The magnitude of the problem dictates that we seek new and cost efficient ways to handle the problem. As much of the earlier discussion has indicated, a critical element in the cost structure contemplated by FIRREA is the number of institutions the RTC will be asked to handle. Minimizing the number of institutions that will have to come to the RTC might be a way to contain the problem.

The RTC staff has begun a study of ways of dealing with institutions before they become wards of the Federal government. In accordance with the Oversight Board directive, we will be examining open-thrift solutions based on our previous experience. Much research needs to be done on this. There will be no costless solutions, but we are looking for new ways to limit the cost of this problem.

II. STRATEGIC PLAN

FIRREA requires the Oversight Board, in consultation with the RTC, to develop a Strategic Plan for conducting the RTC's functions and activities. FIRREA also establishes minimum contents for the Plan.

The Plan developed by the Oversight Board's staff over the last five months was done in consultation with the RTC and the staffs of the Treasury Department, the Department of Housing and Urban Development and the Federal Reserve Board. A draft of the Plan was issued for public comment and many of the public's comments were incorporated into the final plan.

The Strategic Plan represents a compromise resulting from trade offs among many competing views. Our recent experience has led us to request some changes in the Plan. Some of these changes requested of the Oversight Board pertain to the financing of assets and asset put-backs. Overall, we believe it is a good document that balances multiple, sometimes conflicting, concerns and gives direction for managing the task ahead.

The mission of the RTC is to carry out a program to manage and resolve institutions that come under its jurisdiction and to dispose of any residual assets in a manner that:

- maximizes return and minimizes loss;
- minimizes the impact on local real estate and financial markets; and
- maximizes the preservation of the availability and affordability of residential property for low-and moderate-income individuals.

We think the Plan takes a clear position on what appears to be conflicting objectives. Throughout the Plan the Oversight Board makes it clear that it believes minimizing cost is the paramount objective of the RTC.

The Plan provides a substantial amount of guidance to the RTC in six major areas of operations: case resolution; asset disposition; affordable housing; conflicts of interest and ethical standards; external relations; and administration. In each of the six areas, the Plan includes a goal, one or more objectives and various implementation procedures. The Plan primarily relies on the RTC to develop numerous written operating policies and procedures for each area in accordance with established timeframes. We would like now to briefly describe and offer some comments on each of the six main areas covered by the Plan.

Case Resolution

With respect to case resolutions, the goal of the Plan is to: "Manage and resolve institutions under the RTC's jurisdiction in a timely and cost effective manner, while minimizing the negative effects on local financial and real estate markets."

To meet this case resolution goal, the Plan sets six objectives. These are: (1) manage thrifts under the RTC's jurisdiction conservatively; (2) prioritize resolutions based on levels of deterioration; (3) select resolution methods on the basis of cost; (4) develop procedures to keep all interested potential purchasers fully informed of the case resolution process and provide adequate time for the market to determine the best (i.e., the least costly) method of resolution; (5) maintain records sufficient to keep all interested parties informed of the case resolution process; and (6) use the private sector to manage and resolve institutions wherever practicable and efficient. All of these are worthy objectives given the task the RTC must manage. The RTC, and the FDIC before it, has been performing its task consistent with the Plan's objectives in this section.

Manage thrifts under RTC jurisdiction conservatively. The objectives of the RTC when it places an institution into conservatorship are to establish control and oversight while promoting customer confidence; to evaluate the condition of the institution to determine the most cost effective method of resolution; and to operate the institution in a safe and sound manner pending resolution.

To achieve these goals of conservatorship, we have a Managing Agent and one or more Credit Specialists overseeing each conservatorship. The role of the Managing Agent is to ensure that management of the institution adheres to RTC policies and procedures. The Credit Specialist's function is to assist the Managing Agent with regard to RTC policies and procedures as they relate specifically to asset management and disposition. It is important to note that the asset disposition process begins immediately upon conservatorship -- appraisals are brought up to date, conservative underwriting standards are established for the purpose of marketing and selling real estate owned, and RTC delegations of authority are made a part of the operational structure of the institution.

Each Managing Agent is responsible for assessing the condition and acquiring control of the institution, eliminating any abusive or speculative practices, and investigating any evidence of fraudulent practices. New management is brought in to ensure conservative operation and preclude insider abuse, and a business plan for each conservatorship is developed within 60 days of the date the institution is placed into the program. To the extent possible, funding costs are reduced by replacing high-cost funds using RTC advances. Funding demands and RTC advances are contained by downsizing institutions. Downsizing is accomplished by curtailing new lending activity and selling assets where possible.

To address appropriately the unconscionable risk-taking, fraud and insider abuse that were factors in many thrift insolvencies, the RTC has established an Office of Investigations to identify the individuals who caused thrift insolvencies through their reckless mismanagement, fraud or criminal conduct, and to recover the assets they misappropriated. The corps of RTC investigators, which is expected to reach 300 by year-end, will help determine whether and what sort of litigation should be initiated against insiders and others. The RTC will vigorously assist the Department of Justice in prosecuting individuals who benefited personally at the taxpayers' expense.

Starting with a seasoned core of investigators transferred from FDIC's Division of Liquidation, we are building a highly competent, well-educated investigator force from outside the agency. We are requiring all of them to attend a rigorous training program to enhance their investigative skills and their understanding of complex financial transactions. We believe using agency personnel and private sector contractors to gather the facts before decisions are made to embark on costly litigation will give us consistency and accountability in any adverse actions we take against individuals.

Our objective is twofold: to return stolen thrift assets to the American taxpayer, and to help send to jail those who operated outside the law and in so doing benefited personally at the taxpayers expense.

RTC Conservatorship Case Load

	August 9	September	October	November	December	January
Beginning of month	262	262	256	257	275	281
New conservatorships	11	7	10	18	10	31
Resolutions	11	13	9	0	4	5
End of month	262	256	257	275	281	307

The conservatorship program began last February under the auspices of the FDIC. By the time FIRREA was signed into law on August 9, and the RTC began its work, there were 262 thrifts under conservatorship. Since then 87 have been added, and 42 resolved, leaving 307 conservatorship thrifts as of today.

From the outset, downsizing institutions in the program has been a high priority, and it continues to be stressed as a basic objective of conservatorship. Efforts at downsizing have been successful, especially in institutions that have been under conservatorship for a number of months. Of the 243 institutions that were placed into the conservatorship program during the first three quarters of 1989 and that were still in the program at the end of the year, aggregate assets declined by 23.2 percent through November 30, 1989.

At the same time, core funding saw a much smaller decline, while more expensive or rate-sensitive funding fell sharply. These less stable and relatively high-cost sources of funding were replaced to a considerable degree with funds advanced by the RTC. High-cost funds replacement is a strategy the RTC follows to contain operating costs of conservatorship institutions, thus reducing the institutions' operating losses and thereby the ultimate cost of resolution. Essentially, the RTC has been able to shrink these thrifts and their interest expenses while preserving franchise values to the extent possible.

Downsizing of Institutions Under RTC Jurisdiction, Distributed by the Calendar Quarter They Entered the Conservatorship Program
(excludes conservatorships resolved during 1989; dollars in millions)

Qtr.	Number of Thrifts	As of quarter-end before entering conservatorship			As of 11/30/89			% change since conservatorship		
		Assets	Core*	Other**	Assets	Core*	Other**	Assets	Core	Other
89:1	148	$ 67,761	$51,805	$21,828	$50,434	$47,038	$11,360	- 25.6	-9.2	-48.0
89:2	47	23,401	16,945	7,088	18,308	17,128	2,141	- 21.8	+1.1	-69.7
89:3	48	11,259	8,384	2,966	9,971	8,027	2,026	- 11.4	-4.3	-31.7
89:4	38	20,150	14,903	4,243	19,279	14,319	4,219	- 4.3	-3.9	- 0.6
1989	281	$122,571	$92,037	$36,125	$97,993	$86,513	$19,747	- 20.1	-6.0	-45.3

* - Core deposits = all deposits with total balances below $100,000

** - Other funds sources = all deposits with total balances over $100,000 + FHLB advances + reverse repurchase agreements; these figures do not include RTC advances.

NOTE: Assets reported net of reserves.

The 281 institutions under RTC conservatorship as of year-end 1989 had gross assets with a book value of $106.7 billion, based on their financial reports of November 30, 1989. Losses already had been taken on some assets as of this date, resulting in a lower book value as of November 30 than when the assets first came under RTC jurisdiction. The estimated fair market value of these assets, also as of November 30, was $89.2 billion. The following table shows the distribution of assets and the estimated declines in value based on a mark to market.

Type of asset	in millions		Loss (%)
	Book value	Fair value	
Residential mortgage loans	$ 36,740.6	$ 33,513.7	8.8
Other real estate loans	20,707.8	16,631.9	19.7
Total non-real-estate loans	6,466.4	5,405.7	16.4
Mortgage pool securities	9,204.5	8,509.2	7.5
Other investment securities	7,308.4	6,832.8	6.5
Repossessed assets and other real estate owned	13,429.5	8,821.2	34.3
All other assets	12,798.9	9,497.1	25.6
TOTAL ASSETS	106,656.0	89,211.8	16.4

The estimated loss on these assets -- the difference between book and market values -- was $17.4 billion as of November 30, 1989. Additionally, the book liabilities of these 281 institutions exceeded book assets by $13.8 billion. Thus, the estimated total loss on these thrifts was $31.2 billion as of November 30.

To date, 42 cases involving conservatorship institutions have been resolved. These institutions, in 17 different states, were handled using a variety of resolution options, including 28 insured deposit transfers, four insured deposit payoffs, and 10 purchase and assumption transactions. For the 37 institutions completed prior to December 31, 1989 the RTC had sold approximately $2.7 billion of the assets of these thrifts to their acquiring institutions, and retained assets with a book value of about $8.1 billion. The estimated recovery on assets retained is $4.9 billion, resulting in an estimated loss of $3.2 billion on assets in receivership. The five transactions just recently completed are still in the process of settlement between the RTC and the various acquirers.

Prioritize resolutions based on levels of deterioration. In accordance with Oversight Board direction, the RTC has to develop a prioritization schedule for case resolutions. The RTC's implementing procedures for evaluating each institution and determining the priority of case resolutions are attached as Attachment 3. These guidelines and prioritization procedures attempt to comply with the Oversight Board's objective to prioritize based on the rate of deterioration both in absolute and in relative terms. The guidelines leave room to schedule prioritizations on other than just quantitative factors. For instance, the RTC plans to resolve 16 minority-owned institutions now under its jurisdiction relatively early on so as to preserve what chance there may be for them to be restructured as viable enterprises, preferably owned by new minority investors. These will be resolved under a program the RTC will adopt in the near future.

The guidelines for making the prioritization determination focus on four factors:

1. Giving priority to institutions with relatively high rates of deterioration;
2. Minimizing the ongoing risk of exposure to the RTC;
3. Maximizing the recovery of franchise values; and
4. Ensuring the most efficient use of RTC resources and staff.

These factors, using eight quantitative measures in all, are combined to yield a single prioritization schedule. A prioritization schedule is developed nationwide as well as for each of the RTC's four regions to facilitate the resolution of institutions with less than $500 million in assets in those regions. A prioritization schedule is also developed for the major transaction resolution process headquartered in Washington, D.C. Each schedule divides the case load into four levels, or quartiles, of priority -- the most precise level of categorization considered practical.

Each schedule is updated 30 days before the end of each calendar quarter, to reflect additions to the RTC's conservatorship program, changes in investor interest, and new data on institutions already in the conservatorship program.

This approach was used recently to identify those institutions to be marketed by the RTC during the first quarter of 1990. The RTC will continue to publicize the case resolution schedules in order to generate maximum interest in the competitive bidding process.

Select resolution methods on the basis of cost. The RTC's written guidelines for the "Cost Test" calculation required by Section 13(c) of the Federal Deposit Insurance Act and the loss minimization criteria in FIRREA are attached as Attachment 4. Case resolution options are geared towards maximizing competition and minimizing costs. The RTC offers a menu of bid options to open the competitive bidding process, maximizing the private funds brought to the table. This approach is designed to allow the market maximum flexibility and access in the bidding process, and minimize the RTC's costs.

It is especially important that bidders can select the amount of assets they will acquire under current put provisions in that it minimizes the time required for due diligence. This should promote bidder interest and hasten resolutions, thus lowering RTC's cost.

The ability to offer cash to fill the asset short-falls reduces costs, as the market discounts the use of government notes and guarantees. Cash should lead to a better price. It also gives the RTC more flexibility in the resolution process, again helping to minimize cost.

The RTC offers five approaches in its current bidding format:

1. Clean Thrift Option: Bidder acquires only cash and investment-grade and mortgage-backed securities, performing 1-4 family residential mortgage loans, and performing consumer loans, with a put for forged, stolen or fictitious instruments.

2. Modified Clean Thrift Option: Bidder acquires only cash and securities, performing 1-4 family residential mortgage loans, all consumer loans, and other performing loans (construction, multifamily and commercial loans) with an expanded put, including for forged, stolen or fictitious instruments.

3. Modified Whole Thrift Option: Bidder acquires all assets of the institution, except real estate owned and other specific assets, with a put for forged, stolen or fictitious instruments.

4. Whole Thrift Option: Bidder acquires all assets of the institution with a put for forged, stolen or fictitious instruments.

5. Branch-by-Branch Clean Thrift Option: Bidder acquires only fixed assets and limited other assets in certain cases. This approach provides maximum access for smaller parties to the bidding process.

Under all of these options the bidder assumes all deposit liabilities, and is required to pay the contractual interest rate on those deposits for 14 days. Bidders have the option to purchase all fixed assets (required in whole-thrift and branch-by-branch options).

If the RTC fails to receive a bid that meets the "cost test" during the initial round of bidding, then an insured deposit transfer option is offered. This second bidding round might include a simple insured deposit transfer, an insured deposit transfer that also includes the purchase of certain assets, and an insured deposit transfer transaction offered on a branch-by-branch basis.

We believe the broader the marketing, the more open the process, and the more flexible the product, the better the price will be. However, this approach does have some side effects.

The menu of options offered tends to be fairly standardized. Negotiations with individual bidders for more complex or customized transactions are precluded in the interest of open and competitive bidding. While we offer a menu, which certainly will change as the market dictates, customers cannot get customized orders. That may discourage some potential bidders -- particularly in an ever increasing buyer's market.

Another side effect is that some of the options, particularly the whole thrift option, take a lot of time for bidders to evaluate. Depending on the condition of the records of the particular thrift, even the so-called clean thrift option can take a lot of time. Smart buyers shop carefully -- and slowly. The less time they get, the less they are willing to buy. The more buyers, the slower the sale. This is the primary reason that sales of 21 institutions started last quarter rolled over until this quarter. We are happy to report that, of these, nine have been sold, and five more should be resolved this week, with the rest being sold over the next two to four weeks. This would bring our total resolutions to 54, and we have announced the process to start selling another 52 this quarter. Undoubtedly, a number of these will roll over to next quarter. We are in discussions with the Oversight Board on possible approaches to expedite the sales process.

Develop procedures to keep all interested potential purchasers fully informed of the case resolution process and provide adequate time for the market to determine the best (i.e., least costly) method of resolution. It is the RTC's policy to open the bidding process for institutions under its conservatorship to all SAIF or BIF insured depository institutions and corporations, partnerships or individuals who have the potential for receiving approval from chartering authorities for an assisted acquisition. Solicitations for bidders on conservatorship thrifts are made to the greatest number of potential purchasers possible, without regard to existing or potential organizational structure (i.e., thrift or bank). In an effort to attract the widest possible market, the RTC is committed to keep the marketplace of potential purchasers informed of its plans wherever practical.

The RTC publicizes and communicates its case resolution plans, procedures and results to potential purchasers through the use of various techniques including RTC publications, advertising, conferences, outreach programs, and the RTC reading room.

On November 27, 1989, the RTC published "A Buyer's Guide: How to Purchase a Savings Association from the RTC," which was announced in a press release. The Buyer's Guide is found at Attachment 5. This pamphlet explains the RTC's marketing process for the institutions that have come under RTC conservatorship. It is available free of charge. To date, the RTC marketing department has mailed approximately 3,000 copies. These mailings were in response to written requests, general interest calls to the RTC, and calls received on the RTC "hot line." Included with the "Guide" is the RTC clearance package, which contains a financial statement form for all private investors, a bidder fact sheet for financial institutions, and a list of all institutions currently under RTC conservatorship, which is updated weekly.

The RTC toll-free "hot line" also was established on November 27, 1989, and announced in a press release explaining its usage. To date the RTC has responded to approximately 1,600 calls from individuals expressing interest in purchasing a savings institution.

The RTC announces a case resolution schedule for each quarter, listing each savings institution for which active marketing has begun or is planned, along with names and telephone numbers of RTC officials to contact for more information. For each institution listed in the case resolution schedule, a public information package is available containing general information, financial statements and branch location and deposit information. See Attachment 6 for a sample information package.

The RTC also publishes the case resolution schedules and contact names and numbers in the Federal Register and advertises in appropriate newspapers, such as The Wall Street Journal. Samples of these press releases and advertisements are attached as Attachment 7. In addition to these announcements, the RTC schedules marketing conferences to provide potential bidders more information on upcoming resolutions.

Beginning in March 1990, the RTC plans to hold a series of one-day seminars around the country to inform the public on RTC's operations. Among the topics will be how to purchase a savings association from the RTC. All potential purchasers who have contacted the RTC about the case resolution process will receive invitations to these seminars.

Independently, and in concert with RTC's Minority and Women's Affairs Officer, the Washington and Regional Office case resolution staffs will speak at various non-RTC programs around the country in an effort to encourage the active participation in the bidding process of all potential purchasers, including minorities and women.

The RTC maintains a data base which includes, to date, over 2,800 potential bidders who have expressed direct interest in purchasing an insolvent savings association and have completed the clearance package. This list consists of bank holding companies, savings associations, commercial banks, and corporate and private investors.

As outlined in our discussion of case resolution prioritization above, the Strategic Plan calls for a quarterly update and announcement of resolutions planned for the upcoming quarter.

Keep records sufficient to keep all interested parties informed of the case resolution process. In the spring of 1990, the RTC will open a reading room located at 801 17th Street, N.W., Washington, D.C. It will house in one central location all documents of interest to potential purchasers, the media, academicians and the general public, and will be staffed by public information specialists. All of the RTC's policies, procedures, guidelines and other sources of public information, including purchase and assumption agreements entered into since August 8, 1989, will be available for public inspection. Copies of all documents will be made available to any interested party for a nominal charge.

Use the private sector to manage and resolve institutions wherever practicable and efficient. The following are areas in which the RTC is now, or shortly will be, pursuing contracts with private sector firms:

1. Management of conservatorship institutions:

   The RTC has retained individuals under personal services contracts to handle Managing Agent responsibilities at a number of large conservatorships. In addition, the RTC is using significant numbers of individuals in Liquidation-Graded positions with short-term employment contracts. The RTC will continue to rely heavily on the private sector in these areas.

   Investment bankers, brokers and other professionals are under contract to the RTC to assist in the identification, evaluation, pricing and sale of conservatorship assets.

   Institutions under RTC jurisdiction continue to use the services of private contractors where practical and appropriate. In some areas, such as appraisal services, the use of outside firms has increased significantly under the RTC conservatorship program.

2. Disposition of conservatorship institutions:

   The RTC has used outside accounting firms in the Central region for conducting Total Asset Purchase and Assumption (TAPA) reviews. A Request for Proposal (RFP) is under development for the purpose of expanding this into a national program. The plan is to select a number of eligible firms, and then make specific work order requests of firms in that qualified pool. The goal is to have firms conducting these reviews by March.

3. Review and analysis of the 1988 FSLIC deals:

   A RFP soliciting bids from the private sector for work on this project was issued December 8, 1989. It is expected that contracts will be signed and work commenced in early February.

4. Additionally, the following are areas where the use of private sector firms in the management and disposition of institutions by the RTC is being explored:

   Property management firms, for the management of properties held by institutions under RTC conservatorship.

   Investment banking services, especially in the negotiation of resolution transactions for large conservatorship institutions, asset securitization activities, cash management, and portfolio management.

Status of the review of the 1988 FSLIC transactions. The RTC issued a RFP, dated December 8, 1989, for the review and evaluation of the assistance agreements transacted by the FSLIC between January 1, 1988 and August 8, 1989. A copy of the RFP is attached as Attachment 8. Bids were due by January 23, 1990.

The RTC is hiring staff to coordinate the review process, to develop the written report for the RTC Oversight Board and the Congress, and to advise on and assist in the renegotiation of the terms of these transactions where practicable.

The RTC has decided to use private sector contractors for much of the work on this project. The project is highly specialized, complex, and very labor intensive.

The RTC has limited resources to allocate to this especially important project, without diminishing conservatorship operation and resolution efforts. While the RTC will add staff to monitor this project, its urgency virtually compelled the use of outside contractors. The Strategic Plan calls for the completion of this project with reports to the RTC Oversight Board and to the Congress by August 31, 1990. There are 96 separate deals to review in the course of this project. Covering all of them in the time frame and detail required could not be accomplished in-house.

Even without benefit of the contemplated review process, we believe there are aspects of these transactions that can be modified to produce savings. Yield maintenance and asset loss coverage in many of the 1988 transactions appear to be excessively generous. They are especially generous in the context of pre-FIRREA tax incentives. Moveover, in many cases these agreements produce disincentives to the timely disposition of assets. We would contemplate modifications that would continue to adequately compensate the acquirer for carrying the assets but that also would provide incentives for the timely disposition of assets.

We also believe that long term note agreements can be either modified or paid-off depending on cash availability and the overall impact of all changes on the agreements.

Allowing acquiring institutions to reduce the rates of contract deposits. It is RTC policy to allow acquirers of failed thrifts through purchase and assumption transactions to lower interest rates on time deposits two weeks subsequent to the purchase of the thrift. Acquirers, however, are not allowed to lower the rate paid on passbook accounts below their passbook rates, and depositors are allowed to transfer their funds to another institution with no prepayment penalty. This policy benefits the RTC (thus, the taxpayer), since acquirers would pay less for institutions where they have to cover deposits until they mature.

In the last few years, a number of thrifts grew very rapidly by assuming brokered deposits and offering high interest rates. These institutions used the deposit insurance guarantee to go beyond their local area markets to fund their investments. When these investments failed to pay off, the financial health of these institutions began to deteriorate, and they were forced to raise additional funds to provide liquidity. In the Texas region, this need for funds combined with a depressed economy forced many of the distressed financial institutions to aggressively compete for funds in both local and national markets. As a result, interest rates in that part of the country climbed far above the national average. By the time the RTC took control, some of these institutions had as much as 80 percent of their deposits in brokered CDs. Even institutions without a high percentage of brokered funds were paying high interest rates since they also were forced to compete for funds. Therefore, almost all of the RTC institutions have very high deposit costs.

A significant portion of the assets in the failed thrifts consist of delinquent loans and foreclosed real estate. These are not assets that most acquirers wish to purchase. Therefore, the principal value in the failed thrift is its deposit base. If an acquirer was not allowed to adjust the interest rates for the newly acquired deposits, it would calculate the cost of holding high-cost deposits to maturity and deduct this amount from the premium it was willing to pay the RTC. The RTC receives significantly higher bids when the acquirer is allowed to adjust the interest rates for the newly acquired deposits. While the exact amount of the potential savings to the RTC for this policy is unknown, the 472 institutions in conservatorship or on the OTS watch list as of January 3, 1990 held approximately $156 billion in time deposits. If one assumes that one-third of these deposits are high-cost funds on which an acquirer could lower rates by 100 basis points, and that the average maturity from the time of acquisition of the high-cost deposits was six months, the savings to the RTC would be $260 million.

The policy is also fair to the insured depositor. Since the RTC has provided the new institution with the necessary cash and other assets to pay all the insured depositors of the old institutions, the depositors have immediate access to their deposits with no prepayment penalties. Depositors are given two weeks notice of the change in rates so that they can pursue other savings options should they so choose. In the one case to date where depositors were not given sufficient notice, the RTC moved quickly to correct the situation.

Projections as to the number and size of institutions that are expected to be placed within the RTC's jurisdiction. The RTC relies on the Office of Thrift Supervision to identify institutions that it expects to place under the RTC's conservatorship program. In late October 1989, OTS provided the RTC with a list of 223 such institutions, which we refer to as the "OTS Watch List." The assets of these thrifts, as reported on their most recent quarterly financial reports, totalled $165 billion. Since receiving that list, the OTS has placed 59 institutions, with total assets of $41 billion, under conservatorship; three institutions were deleted from the list, while two were added. The number of institutions on the Watch List today is down to 163, with assets of $124 billion.

In discussions with the OTS, the RTC has indicated its ability to take roughly six institutions per week into the conservatorship program. Thus, the RTC could be reasonably expected to handle nearly 300 additions to its conservatorship program over the balance of 1990, if needed.

Asset Disposition

The goal of asset disposition is: "To dispose of real estate and other assets in such a way as to maximize the net present value to the RTC while also minimizing the effect of these transactions on local real estate and financial markets."

To meet the asset disposition goal, the Plan sets four objectives. These are: (1) maximize the net present value recovery to RTC by establishing policies, procedures and guidelines on all phases of the asset disposition process; (2) to the extent practicable and efficient, place assets under private control for management and disposition under a program that employs incentive agreements, assures open competition and assures compliance with the ethics and conflicts provisions of FIRREA; (3) minimize the impact on local real estate and financial markets while marketing assets expeditiously to informed market participants; and (4) fully document the asset management and disposition process.

The policies, procedures, and guidelines required to be established by January 15, 1990 have been submitted to the Oversight Board for review and comment. These guidelines are procedural. They deal with requirements to notify bidders on assets in a timely manner, the prohibition against discriminatory practices, outreach efforts for minorities and women, and recordkeeping requirements for the RTC's semi-annual inventory of real property assets.

The major emphasis of the first objective is to require the RTC to establish comprehensive performance standards and written guidelines on overall asset disposition strategies. The standards and guidelines are due March 30 and are well under way. The guidelines will cover such topics as appropriate marketing techniques, advances, allowable sales prices and appraisal requirements.

The RTC is studying the issues presented by the "distressed area" provisions of FIRREA and like many of the other implementing provisions of the Plan, its policies and procedures in this area will be made public by March 30, 1990. By the end of March, the RTC will develop guidelines on disposition prices in distressed and non-distressed areas.

Lastly, while the RTC is complying with the reporting requirements of FIRREA and the Plan, the RTC will move forward with setting standards and implementing a comprehensive management information system.

Disposition of assets. The asset disposition process starts immediately upon placing an institution in conservatorship under RTC jurisdiction. In addition to implementing prudent operating controls over the institution, RTC personnel aggressively downsize the institution through the sale of liquid assets such as securities, mortgage-backed securities, junk bonds and other issues which are readily marketable.

Procedures to implement the orderly sale of real estate owned assets are given priority. To accomplish this, appraisals are ordered on all properties held by the conservatorship. From this information the RTC will establish appropriate listing prices, expose the property to the widest appropriate market, and negotiate the highest sales price for the acquired property. All real estate owned property with marketable title is eligible for sale from the date that the RTC is named conservator.

The RTC believes it is vitally important to have real estate appraisals that are well prepared, reflect realistic market values and lead to sound business decisions. Thus, we have developed uniform instructions to appraisers that must be followed in preparing appraisals for the RTC. Additionally, we are closely monitoring the state certification of real estate appraisers as required by FIRREA and are actively participating with other federal regulatory agencies in the development of uniform appraisal standards. These standards, which appraisers must comply with, will help provide greater consistency and accuracy in the preparation of appraisals used in federally-related transactions. Finally, as part of the RTC's

Contractor Registration Program, references supplied by appraisers will be verified by RTC staff. This is particularly important in identifying appraisers who have caused substantial losses by previously preparing faulty appraisals for savings associations.

The RTC continues to dispose of assets through the resolution process. The sale of a conservatorship frequently includes the sale of part or all of the association's asset portfolio. We will employ private sector asset management contractors to work out problem loans and actively market for sale all real estate and other owned assets not sold to acquiring institutions.

Securitization and the bulk sale of assets will be an important tool used to dispose of assets. Currently, the Southeast Region is conducting a pilot program for securitization or sale on a whole loan basis of $12 billion in performing mortgage loans held by institutions currently in conservatorship. The concepts used in this pilot project will evolve into a nationwide policy regarding the sale of many different types of assets.

The bulk sale of loans and real estate owned assets will similarly be a tool in the sale of assets once the estimated fair market value has been established. The RTC will package and attempt to sell all types of loans, both performing and non-performing.

Due to the relatively high costs associated with servicing small assets, these assets will be aggressively marketed for sale to the private sector.

Assets, particularly those held by receiverships, will be contracted for management by the private sector. Asset contracting firms will provide a wide variety of services, and it is these firms which will specialize in the collection of problem credits and the management and sale of RTC owned properties.

In managing and disposing of assets, our strategy is to employ the private sector in two stages: (1) portfolio analysis; and (2) asset management and disposition. The portfolio analysis stage will include a detailed review of assets across receiverships. The goal of this process is to structure portfolios of assets based upon product type, geography and other considerations and to gather sufficient information to facilitate a competitive bidding of the asset management and disposition contracts for these portfolios. The information will be collected and placed on computer diskettes to aid in the analysis of the information by the asset managers who will be requested to bid on these contracts.

Once the portfolio analysis is complete, the RTC will request private sector firms to submit bids to manage and dispose of asset portfolios. To facilitate a fair and competitive process, we will provide each prospective bidder with the information gathered in the portfolio analysis stage as discussed above. The evaluation of bids and the awarding of contracts will be based on a review of each bidder's technical and managerial capacity and cost proposal. The winning bidder will be the one with the best overall proposal.

Consistent with the RTC's goal of maximizing net present value, we have provided appropriate incentives in the asset management contracts to ensure that asset managers are rewarded for timely dispositions.

Disposition activities will cover a wide variety of activities. Auctions, bulk sales, and conventional property sales will be used to dispose of real estate owned assets. Other miscellaneous assets will be assigned to private sector contractors for collection or sale once an appropriate valuation can be established.

Status and nature of the asset inventory. As mandated under FIRREA, the RTC's inventory of assets was completed by January 1, 1990 and forwarded to Congress. Additionally, national nonprofit organizations and the National Association of Governors have received an affordable housing volume. We have made the four volumes of inventory available to the general public for a small fee. We have been gratified by the response to date, and have sold over 100,000 individual volumes. Copies also were sent free of charge to certain libraries around the country.

The asset inventory consists of all real estate owned by the RTC as of September 30, 1989. This includes approximately 30,100 pieces, with a book value of approximately $15.8 billion. Our property holdings are concentrated in the Southwest, as reflected below:

State	Commercial	Land	Residential	Total
Oklahoma	89	20	1,466	1,575
Texas	1,340	82	14,328	15,750
Arizona	134	142	1,435	1,711
New Mexico	46	73	518	637
Colorado	182	131	1,273	1,586
Louisiana	242	60	2,132	2,434
Subtotal	2,033	508	21,152	23,693
National Totals	2,516	794	26,813	30,123
Percent of National Total	81%	64%	79%	79%
Book Value (Billions)	$7.4	$0.8	$7.6	$15.8

All of these properties are for sale. In many cases, however, an asking price has not been established due to the need for an independent, updated appraisal. We have made the establishment of asking prices a top priority.

One of our primary objectives is to be responsive to offers to purchase assets from the RTC. Accordingly, we have implemented a policy requiring a response to all offers within thirty days. This policy exceeds the requirements of FIRREA in that a response is also required when no final response to an offer can be given. For example, when an account officer receives an offer to purchase property where a valuation has not been established, the account officer must tell the prospective purchaser, in writing, when a listing price will be established. In short, RTC is a sales organization and high quality service to the public is an absolute requirement.

As we move forward, our plans are to enhance the information in the inventory and make it more timely and accessible by employing several mediums. For example, we will be providing the inventory on computer diskettes or cdROMs. Moreover, we plan to provide a central database which can be accessed through an 800 number by individuals with modem equipped PCs.

Description and fair market value of assets held by the RTC. The estimated fair market value of all assets held in receivership by the RTC as of December 31, 1989 was reported to be $4.7 billion with an approximate book value of $7.9 billion. These assets include securities, loans, fixed assets, real estate owned, and other assets.

Owned assets (real estate and miscellaneous personal property) total $1.9 billion. Illiquid and distressed mortgages total $4.9 billion. Loans, securities and other assets total $1.1 billion. The normal collection process will involve foreclosure on a substantial number of real estate parcels currently pledged as collateral for loans in the mortgage category. The exact number of parcels to be foreclosed is impossible to predict until financial capacity of the individual mortgagors is determined. Obviously, we strongly prefer prudent restructuring of loans over foreclosure.

Affordable Housing

The goal of the affordable housing provisions is: "To dispose of eligible single and multi-family residential properties in a way that maximizes the preservation of the availability and affordability of residential real property for low- and moderate-income individuals."

The objectives of the affordable housing provisions section are two-fold. They are: (1) implement the statutory requirements of FIRREA; and (2) fully document the program and its results.

While the implementation procedures are numerous, they can be summarized as requiring the RTC to: (1) implement a pilot program for eligible properties as rapidly as possible; (2) consult with HUD, other federal agencies and affected state housing agencies; and (3) by March 30, 1990, implement an overall systematic affordable housing program using the private sector and other federal and state agencies wherever practicable.

The RTC has developed interim guidelines to address the eligible residential housing requirements of FIRREA. These guidelines have been forwarded to the Oversight Board for review and approval prior to beginning a demonstration program. A Program Director, Program Coordinator, and staff in Regional offices are in place to implement the affordable housing program.

The RTC, working with the National Governors Association, has contacted state governors for support in confirming the designation of housing finance agencies as clearinghouses and to identify other housing agencies to support our efforts to ensure that qualified purchasers benefit from the sale of affordable housing properties. Governors and state housing finance agencies each received a copy of the real estate owned inventory, Volume IV, Affordable Housing Properties. The volume listing all residential properties is being mailed to state housing agencies. We are making the full listing available to give clearinghouses advance notice of all properties currently owned that could fall within the scope of the program.

The procedures governing the involvement of state housing agencies and national nonprofits were defined as a part of our interim guidelines after extensive meetings with the organizations identified in the law and other parties who expressed an interest in serving as clearinghouses. We recognize the support these organizations can provide to the RTC in disseminating property information expeditiously so that qualified purchasers have the benefit of previewing and making an offer on eligible properties.

The RTC has consulted with HUD, other federal agencies, and secondary market entities to begin to identify and arrange for financing of eligible property sales. HUD's office of Intergovernmental Relations is scheduling a series of meetings within the upcoming weeks for RTC personnel to meet HUD staff with specific program responsibility. We have met with the Federal Housing Finance Board, both in Washington and at the regional level, to solicit their cooperation in providing financing from their affordable housing and community investment funds. Contacts also have been established with national nonprofit organizations that also will serve as clearinghouses and technical assistance advisors.

The RTC plans to begin marketing properties under the interim guidelines no later than the end of the month. Our regional staff informs us that as a result of the dissemination of the affordable housing inventory there have been numerous expressions of interest by potentially qualified buyers.

Approximately 700 properties will be offered pursuant to the interim guidelines. The Oversight Board has encouraged the RTC to implement this demonstration program and to analyze the results before offering price discounts and concessionary financing. We expect to use the demonstration effort to test our procedures for disseminating property information through clearinghouses, to determine if subsidies and financing are needed, and to document successful examples of the involvement of nonprofit and state agencies in purchasing properties to provide for assisted housing for low- and moderate-income renters.

By far, however, the vast majority of affordable housing is held by conservatorships. We have identified 10,000 properties (half of which are in Texas) that appear to meet the affordable housing criteria. Surely, as new appraisals come in, the numbers will increase. We have heard concerns that we may try to sell all these properties outside the low income housing program because FIRREA specifically excludes conservatorships. That is not our intent. We have issued instructions to conservatorships to not engage in any aggressive programs to sell these properties, although they are allowed to sell in the normal course of business. We anticipate that the vast majority of these properties will pass to the RTC as thrifts are sold.

Another concern we have heard expressed is that the RTC initially will overvalue residential properties to allow them to escape the low income housing program. Again, that is not our intention, nor would it be very practical. Once we determine a residential property should qualify, we will place it in the program. In short, we will comply fully with the intent of the law as directed by the Oversight Board.

Finally, provision of asset management, brokerage and buyer qualification services by public agencies and private sector firms is being explored.

Ethical and Conflict of Interest Guidelines

The goal of the Conflicts of Interest and Ethical Standards section is: "Adopt conflicts of interest and ethical standards for RTC employees, officers, advisory board members, contractors, and agents."

The Plan includes two objectives under this goal. They are: (1) develop regulations that - (a) govern conflicts of interest, ethical responsibilities, and past employment restrictions for RTC employees, (b) govern conflicts of interest for contractors, and (c) ensure that RTC officers, employees, advisory board members, contractors and agents meet appropriate standards; and (2) develop policies and procedures for avoiding political favoritism and undue influence.

Conflict of interest and ethical standards. Subsequent to the publication for public comment of the Oversight Board's Strategic Plan, the Oversight Board and the RTC issued, for a 45-day comment period, a joint notice of proposed rulemaking entitled Qualification of, Ethical Standards of Conduct for, and Restrictions on the Use of Confidential Information by, Independent Contractors. The proposed rule was drafted after consideration of the comments received on the earlier interim statement of principles, which established minimum standards of ethical conduct for independent contractors retained by the RTC. The proposed rule further reflects specific concerns of the Oversight Board. These concerns include the flexibility to meet the statutory mandate of the RTC to engage the services of independent contractors, as well as the protection and preservation of the integrity of the procedures and processes we will follow in performing our duties.

As with the development of any regulatory procedures, there were comments from proponents and opponents of the standards of conduct in the interim statement of principles and of the Oversight Board's ethical concerns, as expressed in the Strategic Plan. Some comments indicated that certain standards in the interim statement of principles were overly stringent and would have a negative effect on the overall success of the RTC. Others said that we were correct in adopting stringent conflict of interest and ethical standards for outside contractors and that the standards should be rigorously enforced.

We anticipate a three-phased implementation of the independent contractor ethics program. Phase one is the qualifying phase. Contractors wishing to participate in contracting with the RTC must first qualify according to standards for competence, experience, fitness and integrity. They also must not be subject to any mandatory bar to contracting. Phase two is triggered by a solicitation for services. The solicitation will involve certain certifications and representations by the qualified contractor. This will include information and certifications about organizational and personal conflicts of interest. Phase three, the award phase, will include a contractual agreement stating that the contractor will comply with all requirements of the RTC's independent contractor regulations.

We are currently drafting final regulations reflecting the concerns expressed by the public, in a manner consistent with the public trust that has been placed upon the agency (See Attachment 9 for proposed Regulation and Joint Notice of Proposed Rulemaking.)

In addition to the proposed Regulations for Independent Contractors, the RTC Board has issued proposed regulations for RTC employees, prescribing ethical and other standards of conduct for RTC employees no less stringent than those applicable to FDIC employees.

Measures to Avoid Political Favoritism and Undue Influence. FIRREA requires the RTC to establish policies and procedures for avoiding political favoritism and undue influence in the course of its activities. The Strategic Plan requires specific written guidelines and procedures and draws upon current FDIC policies. The Strategic Plan further requires that, prior to implementation of permanent procedures, RTC employees must log all communications between public officials (or their staffs) and RTC employees which are intended to influence a case specific decision currently before the RTC. These records must be made available for public inspection.

To meet these requirements, we have developed a draft policy statement and procedures for RTC employee interaction with public officials. (See Attachment 10 for a copy of the proposal.) These procedures will allow RTC employees to respond to all appropriate inquiries, requests or complaints made by or on behalf of public officials. They will not allow responses that could result in a personal or financial benefit otherwise unavailable through the normal and efficient course of RTC operations. We believe these policies are fair to all parties. However, because of the nature of these provisions, we would appreciate any feedback that members of the Committee wish to provide. We will gladly consider any comments before finalizing these policies.

To meet the interim log-keeping requirements of the Strategic Plan, we have given all employees notice that telephone logs must be maintained. Such logs are now in use throughout the agency. (See Attachment 11 for a copy of the explanatory memorandum and the log sheet.) This requirement will be made permanent under the above proposed procedures.

External Relations

The goal of the External Relations section is: Establish and maintain open communications with the Congress, other government offices, and the public to increase understanding of RTC policies and actions.

The objectives of this section are to: (1) promote public understanding of the RTC's policies and actions, and (2) consult with other government offices in developing guidelines and procedures.

As discussed earlier and detailed in Attachments 5, 6 and 7, the RTC has developed a number of ways to keep the public informed of its operations. In addition to existing publications, advertisements, toll-free numbers, seminars and a reading room, the RTC soon will be publishing guides on buying assets and contracting for asset management, legal, and other services. Also, the RTC has increased its efforts to insure the timely response to requests under the Freedom of Information Act.

Administration

The goal of the Administration section is to: Assure that the RTC has sufficient and effectively managed human and financial resources to achieve the mission and goals of the agency.

The objectives of this section are: (1) assure that resources are effectively managed; (2) ensure fiscal responsibility; (3) respond in a timely and efficient manner; and (4) cooperate with independent auditors, the Inspector General and the Oversight Board.

In addressing objectives in this section of the Strategic Plan, items related to RTC operations in which the Committee has expressed an interest will be covered in some detail. In addition to discussing the RTC's progress in meeting the objectives stated in the Strategic Plan, the proposed administrative expense budget, staffing plans, and status of the integration of Federal Home Loan Bank Board (FHLBB) and Federal Savings and Loan Insurance Corporation (FSLIC) staff into the RTC and FDIC will be presented.

Operating budgets and plans. Our efforts to meet the objective of effective resource management include the development and submittal of operating and administrative expense budgets for each quarter through calendar year 1990. Details of the most recent administrative expense budget approved by the RTC Board are included as Attachment 12.

Many variables affect the RTC's budgets including the number of S&Ls under RTC control, type and pace of resolutions, availability of qualified contractors, and recovery rate of various assets. Until these variables can be better forecast, it is very difficult to provide meaningful budget estimates for future periods. As a result, the RTC Board has approved only a first quarter 1990 budget. We will review financial performance mid-quarter and then consider budgets for the remaining quarters of 1990.

In the first quarter's budget, about $230 million was requested for operating expenses. Of this amount, 70 percent is attributable to outside legal and asset management fees, and 15 percent to salaries and benefits. Early estimates suggest that the RTC's operating budget for 1990 could approach $1.5 to $2.0 billion assuming an annual resolution rate of about 200 institutions. We anticipate that 85 percent of this budget will be for outside services, which reflects our goal of at least 80 to 90 percent of asset workload being contracted out to the private sector.

Resource allocation and reprogramming. As part of the Strategic Plan requirements and to assure that the RTC's resources are effectively managed, we are in the process of developing and implementing bottom-up budget procedures by which estimates of administrative expenses can be formulated into budgeted amounts that reflect current operating plans of the organization. These estimates, once approved, will form the basis for ongoing monitoring of expenditures, variance reporting, and reallocation of resources to most efficiently and effectively meet corporation goals and objectives, much in the same manner as is being done in the FDIC. The RTC provides significant input to the FDIC Quarterly Corporation Status Report and, when variables affecting the RTC budget stabilize, we will use performance measures and expenditure data from this report to reassess and reallocate resources as needed.

Staffing plans. Like the budget, RTC staffing is heavily dependent upon many variables. A key variable is the ability to successfully contract with the private sector for an unprecedented amount of work. Included in the preparation of materials to justify our budget requests are staffing plans for first quarter 1990, including organizational charts and functional distribution of staff. Attachment 13 provides this detailed information.

Currently, the RTC has almost 1,900 dedicated personnel, of which over 600 are Managing Agents and their staffs in conservatorships. Although between 15 percent and 20 percent of the current staff is located in Washington, based on staffing projections this ratio should decline to about 10 percent by the end of 1990.

Although it is always a difficult process to merge professional staffs from organizations with different missions and backgrounds, the RTC continues to place former FSLIC, FHLBB, and FADA personnel in RTC jobs. In fact, most of RTC current staffing comes from FSLIC and FDIC. Six hundred and fifty people are from FDIC, largely from the Division of Liquidation. Nearly 190 people from various FSLIC operations were allocated to the RTC and RTC support units in the FDIC. In addition, the RTC has hired about 20 persons from the FHLBB and 80 from FADA.

Due to the non-permanent nature of the RTC, we are attempting wherever possible to hire temporary professional and support personnel. Over 60 percent of the field staff are non-career, temporary employees hired under appointments of one to three years in length. This ratio will increase as temporary employees continue to account for most new hires.

Organizational structure. The RTC organizational structure is still evolving, but we plan to be a decentralized corporation. Included in Attachment 13 is the organizational chart for Washington as well as charts for typical regional offices. The RTC will be divided into four regions, and we expect to have a total of 14 consolidated operational field offices (CFOs). Ten of the CFOs are ready to begin operations now and we plan to sign leases by the end of the first quarter 1990. We have initiated the staffing process and we will be able to fully staff all sites after space has been acquired. Regional offices will oversee all resolution and asset and contracting operations. Consolidated field offices will focus on asset and contract oversight, performing the majority of work in this area.

Minority- and Women's-Outreach Program. Included in the implementing procedures of this section is the requirement that RTC develop and present to the RTC Board a Minority- and Women's-Outreach Program in accordance with the policies outlined in the discussion portion of the Plan. An Interim Minority- and Women's-Outreach Program was approved by the RTC Board on December 12, 1989. The Program involves the identification, certification, promotion, and solicitation of minority- and women-owned firms for participation in RTC contracting activities. Staff will be dedicated by the RTC to the implementation and overview of this Program (See Attachment 14 for a copy of the Interim Program). In concert with RTC's Minority and Women's Affairs Officer, RTC case resolution staffs will speak at various non-RTC programs around the country in an effort to encourage the active participation of minorities and women in the bidding process.

The RTC will amend its Interim Outreach Program in the near future to incorporate the technical factor adjustments and price advantages approved by the Oversight Board. These modifications to RTC's Interim Outreach Program were sought by the RTC. Our Report on this program required by FIRREA already has been forwarded to the Senate leadership. The RTC is fully committed to including women and minorities in our contracting program.

Fiscal responsibility, responsive reporting, and cooperation with auditors. The RTC intends to cooperate with the Oversight Board, Congress, other Federal agencies, the General Accounting Office, and the Inspector General. We will do our best to be timely and efficient in all our activities. We will create systems and implementing procedures to ensure fiscal responsibility and effective management of the RTC's resources.

Utilization of the private sector. Draft guidelines have been developed for utilization of the private sector as required by FIRREA. We are committed to using the private sector extensively in carrying out our mission. We have developed a three-phase process for evaluating potential contractors which encompasses (1) ethical standards, (2) technical competence and (3) competitive bidding procedures.

We have sent to about 3,500 interested parties the RTC's contractor application packages. The contractor's application package is found at Attachment 15. These packages will guide the interested individuals and firms through this three-phase process and potentially qualify them for contracting opportunities with the RTC. RTC offices in Washington, the Regions and the Consolidated Sites are hiring employees to specifically ensure implementation of the RTC's contracting guidelines.

III. OVERSIGHT BOARD

There has been considerable criticism of the pace at which the RTC is moving in the sale of institutions and assets during its first six months. In our view, the pace has been satisfactory, although it surely could have been swifter. We have just described many of the accomplishments of the RTC since its creation in early August of last year.

Part of this discussion has centered on the structure of the RTC-Oversight Board and its effect on the pace of dealing with insolvent savings associations. It is our view that the working relations between the RTC and the Oversight Board have been good as a result of outstanding efforts by Executive Director David C. Cooke and Oversight Board President Dan Kearney.

It also is evident that we have an unusual structure. There are two Boards involved each of whose duties are provided by law. This necessarily makes doing business more time consuming than if we were working in a more traditional structure. The structure, however, provides more controls and policy checks than would be available in a more traditional organization. Given the unusual, precedent-setting job involved in cleaning up the thrift industry, such control and such a unique structure may be appropriate.

How effectively it will operate is a question that should be examined over time. It is too early to make a judgement at this point. We raise it now only in answer to the "too slow" comments. The system in place is slower and more bureaucratic than a more normal structure with one board and one organization.

IV. FDIC ISSUES

Status of Savings Association System and SAIF

The savings association system is entering a transitional period which will determine the fate of the undercapitalized segment of the industry. Events during this transitional period will determine the size of the SAIF assessment base, that is, the deposits of SAIF-insured institutions. The growth of this base has varied dramatically over time. From mid-1978 to the end of 1982, deposits at (presently) SAIF-insured institutions grew at an annual rate of 7.4 percent. This was followed by two years of rapid deposit growth of 19.4 percent per year. From the end of 1984 through the first quarter of 1988, deposits grew at a more normal 6.4 percent annual rate. As of the third quarter of 1989, savings association deposits were as they were in March, 1988. Deposit outflows, however, have occurred in recent months.

The SAIF assessment base was $957 billion as of September 30, 1989, down from $972 billion in December 1988 -- but largely unchanged from $957 billion in March, 1989 and $960 billion in June, 1989. While it is too early to predict the long-term trend of the SAIF assessment base, there are some reasons to expect that the base may decline in the short run. The new capital standards imposed on thrifts by FIRREA have forced many thrifts attempting to conform to the new standards to shrink in order to increase their capital ratio and others to at least stop growing so they can remain in compliance with the new standards.

This spring, the Office of Thrift Supervision will issue rules for the interest rate risk component of the Risk Based Capital standard. These regulations might increase the risk based capital required for some thrifts and could thus cause additional institutions to curtail their growth or force further downsizing if institutions are failing their capital requirements. As thrifts adapt to the new regulatory environment, the assessment base may begin to grow. However, that does not seem likely in the short term.

In light of the uncertainties facing the industry during the next few years, the FDIC has not felt that a "projection" of the SAIF assessment base would be meaningful. The current condition of many S&Ls may vary sharply from what is indicated by their public financial statements and old examination reports. Future events are even more uncertain. These include the behavior of interest rates, the condition of local real estate markets, and the condition of the economy generally. All these factors will influence the ability of the thrift industry to attract capital and hence to grow. We have found this to be the case in some of the savings associations we have examined so far.

FDIC Examination of Savings Associations

Since the enactment of FIRREA in August of last year and through January 15, the FDIC has commenced or completed 363 examinations of savings associations. The following schedule presents a regional breakdown of those examinations:

Region	Total
Atlanta	21
Boston	23
Chicago	94
Dallas	37
Kansas City	58
Memphis	41
New York	36
San Francisco	53
Total	363

In most instances, our examinations have been conducted in conjunction with an OTS examination or other presence at the institution. This reflects our desire to avoid inappropriate duplication with the OTS and to avoid placing an unnecessary burden on the institutions. We anticipate that the pace of examinations will escalate. Currently, our pace is somewhat deliberate due to the types of institutions initially targeted for examination.

The primary criteria for selecting which thrifts should be examined first has been the perceived degree to which they were believed to present exposure to the Savings Association Insurance Fund. In reviewing that risk perception, associations were selected because of low capital, asset problems, poor earnings, or because they otherwise bore a risk to either the RTC or the Savings Association Insurance Fund. Also of importance initially is whether an OTS examination of the institution has been scheduled.

The asset quality of many of the institutions examined to date has been lower than expected. In many cases this has been the result of a marked degree of deterioration in real estate collateral values and paying capacities over that previously noted.

In general, savings associations that engaged in lending or other activities beyond residential real estate loans are more likely to be experiencing asset-quality problems. In these institutions, reserves for loan losses are generally inadequate and earnings are poor due to low net interest margins and high fixed overhead expenses. Capital is inadequate and a number of these savings associations are found to be insolvent.

To the degree that we examined better-rated institutions, we found many thrifts which are exactly as they were portrayed to be -- single-family residential lenders with few asset-quality problems but with unbalanced rate sensitivity positions resulting in marginal earning capacity.

Status of Guidelines and Regulations

FIRREA places certain responsibilities with the FDIC for matters that can have a direct effect on the RTC's ability to resolve problem thrift situations in a cost effective and non-disruptive manner. Of particular importance are the FDIC's responsibilities with respect to setting entrance and exit fees and developing guidelines covering open-thrift assistance.

FIRREA mandates that both exit and entrance fees be levied in all case where the insurance liability for deposits is converted from one deposit insurance fund to the other. The FDIC is charged with the sole responsibility to set the entrance and exit fees for BIF-to-SAIF conversions; interim regulations have been issued to cover these types of transactions.

Because of the relationship of insurance premiums paid by SAIF-members and the funds that become available to service FICO borrowings, FIRREA placed authority to set exit fees for SAIF-to-BIF conversions jointly with Treasury and the FDIC. Understandably, Treasury is more concerned with the servicing of FICO obligations, whereas the FDIC's focus is on protecting the integrity of BIF and SAIF, in part by facilitating resolutions of insolvent thrifts. While these are competing goals, Treasury and the FDIC have reached a compromise, and new regulations in this regard will be issued shortly.

Another area of importance is developing and publishing criteria the FDIC will use in determining whether a request for open thrift assistance should be recommended to the RTC. As indicated earlier, it is important that a reasonable policy be developed and, when appropriate, thrifts be rehabilitated without placing assets into liquidation. The FDIC will be publishing proposed guidelines and, where appropriate, regulations in the next few weeks.

Placement of Employees

By early February 1990 the FDIC anticipates that all of the personnel reassignments involving former FSLIC and FHLBB employees will be completed. To date, 400 of the affected employees (out of a total of 750) have been placed in jobs either at the FDIC or the RTC.

V. LIQUIDATION OF FADA

FIRREA requires liquidation of the Federal Asset Disposition Association (FADA) within 180 days of enactment (February 5, 1990). The FDIC, as manager of the RTC, is responsible for carrying out this liquidation. With the exception of a final distribution of funds, FADA will be liquidated by February 5, 1990. At that point, only the resolution of outstanding litigation claims will remain before final distribution can be made to the FSLIC Resolution Fund as the sole shareholder of FADA. Attachment 16 provides a detailed outline of the steps taken to accomplish the goal of liquidating FADA.

Senator KERRY. If I could ask one last question, Mr. Seidman—I did not know that time would go so quickly—I believe you received a letter from Mayor Flynn of Boston regarding some 78 troubled condominiums that are going to come under the control of the RTC. And the suggestion has been made in keeping with the primary purposes of the RTC, to maximize preservation of affordable housing, that this be converted, that the control be transferred to nonprofit developers and so forth.

I wonder if you could just comment whether or not that fits within the statutory obligations and objectives, and how that approach might be received.

Mr. SEIDMAN. Well, we are studying that letter right now. I do not think we have gotten beyond that at this point.

We have just received the letter, so we are studying it to see if it will be possible. But I cannot give you an answer now.

Senator KERRY. OK. I would like to simply say that I think that is a very important approach. I think it is a good way of disposing of assets and dealing with a particular problem we have. And if there are ways to make that proposal, to improve it and to bring it, if it is somehow, somewhat outside of the spirit or intent or objectives, we would certainly like to work with you to bring it within it.

Mr. SEIDMAN. If I might say so, Senator, on your previous question, I did inform the committees in 1986 that I thought the change in the real estate law was going to be very detrimental to banking, and would probably cost more than it would save.

Senator KERRY. Yes. Well, you know, this is not the moment to revisit that. But I think that the punitive aspects of it, after telling people to play by certain rules in 1981, and then not only changing the rules but punishing them for doing so, having played by them, was in itself I thought absurd.

But I think we have created a certain subset of problems here. And I would like to see us see if we cannot be creative somehow, to find some ways out of it.

Mr. Chairman, thank you.

The CHAIRMAN. Very good.

Senator Wirth.

Senator WIRTH. Thank you very much, Mr. Chairman.

Thank you all for being here. I really greatly respect the enormity of the job that you have to do, and the complexity of it.

First, a statement, if I might, maybe to you, Mr. Robson and Mr. Seidman. In the legislation on the RTC, there is a requirement that the RTC identify properties with natural, cultural, recreational, or scientific values. One of the purposes of that language being in there was to try to make a little bit of a silk purse out of this situation, that there are probably a lot of properties there that would be of great interest to State historical societies, environmental groups, open space councils, and so on; and to see if we could get those inventoried and that inventory made available to public groups who might be interested in purchasing them.

Since November, we have been attempting to coordinate this. I wrote to Secretary Brady in the middle of November. We have had numerous meetings with the staffs of the RTC Board and with Mr.

Seidman's staff. And we get a picture of not very much coordination or attention to this.

For example, the Fish and Wildlife Service has offered their very significant resources to help in this inventory. It has not happened. We have got the resources available there. And I would just urge you, if I might, maybe to Secretary Brady, the Chairman of the Board, and Mr. Seidman, to you and your staff, to please ask you to coordinate your efforts and the very significant offer from Fish and Wildlife to come in and help.

I am sure that maybe there is a silk purse that can be made out of this in the housing area, too, Mr. Secretary, and I know you have been working on this to see if we can get some of these resources in the areas where it is needed. And I am not banging on you on this, because I know that you all have really targeted on that at HUD. I just would hope that you all could do something in this other area.

Let me, if I might, while I have got this coordination issue in front of us, ask you, if I might, Mr. Seidman, there has been a lot of disussion earlier to the members of the Oversight Board about the resources that were made available.

I would ask you if, in fact, you are satisfied with the resources that you have at the RTC and the FDIC. Are they adequate for your doing the job, And second, do you have the policy guidelines from the RTC Oversight Board necessary to make the series of very important decisions that you have to make?

Mr. SEIDMAN. The resources are adequate at this time, and we have indicated that we expect that we will need further resources at the end of February, or shortly thereafter. And that will be the working capital of course that has been discussed so much here today.

As far as procedures are going, they are not all finished, but they have been proceeding along. Some of them were still waiting for final approval, but I think both sides have been working very hard to get them done and in place.

Senator WIRTH. So everything is fine between the people who have to carry this out and the Oversight Board, in terms of resources and policy direction?

Are there any recommendations for the committee, where we might help to augment or facilitate the coordination beteeen the Oversight Board and the policy recommendations and your operations?

Mr. SEIDMAN. Well, I have said in my testimony that obviously the structure here is a new one, different I think than anything ever tried before exactly this way in Government. It involves two separate boards of directors, two separate executive officers, at least two staffs plus the staffs of the various members on the board.

And that means there are a lot more people involved in making decisions and in getting final action than there would be if it were the normal situation where the Congress appropriated to a particular agency.

That means, in my view, it is and always will be a somewhat slower type of structure. Now, that was put in place because the administration felt—and I do not question it—that they wanted additional control. And the more controls, and the more people you get involved, then the slower the procedure will be.

So I do not think it is going to be material in the long run, but I think it is something that the Congress ought to keep an eye on.

Senator WIRTH. Mr. Greenspan, before you assumed your current office, you had advocated expanded thrift powers, including direct investment. As you know, many thrifts that engaged in direct investment have contributed to the collapse of the thrift industry, and those stories are now legion.

Has this history altered any of your own thinking about further deregulation of bank investment powers? Or, have we learned anything from the thrift crisis that ought to be a lesson for the discussion about expanded powers for commercial banks?

Mr. GREENSPAN. Not in a general way, sir. The argument I was making for direct investment is essentially the argument that I would still make today; which is the argument which responds essentially to Senator Heinz's question about the QTL.

In my view, a thrift institution which is required by law to have very significant long-term assets financed by short-term liabilities is a special institution which can exist only in an environment in which there is no inflation and no change in interest rates.

We learned in the late 1970's and early 1980's that this type of institution was not sufficiently flexible to function in a manner to serve the needs that it was originally created to serve.

And as a consequence of that, the endeavor to increase the maturity of the liabilities, which they tried to do in the early 1980's by selling longer-term debentures, did not succeed. They did not get enough of them, they did not choose to do enough. Similarly, the variable rate mortgages at the time did not adequately make the asset side sufficiently flexible.

So what I was arguing then and would still argue today is that a specialized institution cannot be constructed in our environment, unless it is given sufficient flexibility to function in a variable environment.

And had I had the chance, I would have subscribed to the comments that Senator Heinz was making earlier about the QTL, which I think is something which is going to cause a problem for us.

In my judgment, the most important thing is to make certain that the asset and the liability sides of depository institutions' balance sheets function in a manner in which the interest rate risk is minimal, if you can do it. To the extent that that is not there, then I think it is mandatory to significantly increase capital requirements.

And in my judgment, the depository institution which will be viable in the future is one which does have the capability of not subjecting itself to significant interest rate risk and will be sufficiently capitalized to absorb changes in the economic environment.

And in that view, we have got to be certain there is adequate capital. FIRREA did address that subject. Before we work our way back, which is the other side of the issue which Senator Heinz was raising, we have to be careful to make certain that we do not, in an endeavor to create more flexibility, then create again a high degree of risk.

Senator WIRTH. That means that, with adequate capital then, direct investment would have been all right? With adequate capital and a variety of other kinds of investments? That is the important variable?

Mr. GREENSPAN. Senator, with adequate capital, one can take any limited number of risks. The question that is always a problem is that, when one takes it on one's asset side of the balance sheet with inadequate capital, what you are trying to do is get a relatively high return type of asset, but without having the correspondent risk buffer, which means adequate capital.

Senator WIRTH. Mr. Chairman, thank you.

Mr. Seidman, if we might get together with your staff on that earlier question related to the inventory of those resources, we would appreciate that, and see if we might be able to facilitate that coordination.

Mr. SEIDMAN. We would be pleased to do that.

Senator WIRTH. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. I do not want to pursue this at length right now, because I want to go to something else that is very important, to Chairman Greenspan, but when you testified here last year in February and March—I do not know the precise date; there was a schedule of hearings—but on one of those dates you were present. You indicated at that time that any activities that broadened out—and you raised the risk issue—should either be in a separate subsidiary or in a holding company. I mean, you made that differentiation. I do not assume your position has changed. Very good.

I want to talk to you for a minute here about the interest rate situation we are in, because it bears very importantly on how we work our way through this problem and other problems.

We have seen a very abrupt change in interest rates, long interest rates, say 30-year bonds. We are down below 8 percent, I would think as recently as 5 or 6 weeks ago, as nearly as memory serves me. And you are nodding in the affirmative.

Yesterday, we were up at about 8.6 percent. And I do not know what the market is doing today, but it was in the range of 8.5, 8.6 percent. That is a very abrupt change in a short space of time.

It seems to me, just as one observer, that not all that much has changed internally in that 6-week span of time, within say our national economy or within our country. Obviously, there is a flow of news each day. But it would look to me that external events seem to have more of a bearing on this sudden shift in interest rates, where they were trending down and now have ratcheted up quite abruptly, and I think to quite a degree.

And the question that I have, I would like you to shed some light on this and on the concern that I have and that I hear many others expressing, that we are finding over time that more and more power, financial and economic power, seems to be shifting overseas; and that developments elsewhere, monetary policy developments, trade policy developments, economic strength in other nations and in other centers of power and decision making in other countries, are beginning to have a greater effect here.

And we find ourselves in a situation where we may not be able to do precisely what we would like to do with respect to monetary policy and other things, because we are finding that the world is changing in such a way that we are going to find oursleves bounced around to some degree by events outside our shores.

I would like you to comment on this as directly as you can.

Mr. GREENSPAN. Mr. Chairman, I think you are raising an issue which is somewhat broader than the particular issue which seems to be confronting the United States.

You are raising the question which we have all been aware of; namely, the increasing globalization of trade and finance. In the last 10 or 15 years—in fact, even further back than that—there has been very dramatic evidence of internationalization occurring in a way which we have not seen earlier.

It is first showing up in a significant down-sizing in the type of goods that we produce largely as we move to a higher state of technology. We are producing much smaller things. For example, 50 years ago we used to produce a radio which was this size; now, we can put the same function into something very small. And one can show example after example of where the size of the output of this country and the world is coming down.

This means that it is easier to move goods, and it is easier therefore to move them across national boundaries. So that it is not a surprise to find that there has been a very significant increase in the ratio of international trade to domestic GNP's, which is another way of saying on average that individual countries' ratio of imports to domestic demand have been rising considerably.

Concurrent with that has been, of necessity, financial instruments which are doing precisely the same thing. That is, the degree of internationalization of markets to finance this has also been moving apace. And the consequence of this is that we are beginning to find massive ever-increasing flows across national boundaries all sorts of financial instruments.

Now, this is not an issue that only confronts the United States, because we are doing the same thing externally. That is, the American dollar is having a very profound effect on other countries. In other words, they are being influenced by what we do.

And the truth of the matter is that both are correct, that there is a very clear set of trends that are irreversible. And they are irreversible because the down-sizing issue is a knowledge-based change, and knowledge is not reversible. So that we are going to be looking at what appears to be a greater degree of instability, as the globalization process continues.

As I indicated to the Joint Economic Committee yesterday, I think that the sense that that is creating instability is largely false. It is really a dynamic process, which probably more relates to growth than it does to individual problems.

So I do not deny that events in one country are spilling over into others, but these impacts will likely be temporary. And I think it is important to understand that it is a generalized process, one which will continue, and not one which we ought to fear. It is probably, so far as the standards of living of the world as a whole are concerned, good, not bad.

The CHAIRMAN. Well, I want to ask one follow-up to that. That is a pretty abrupt increase in long rates in a very short space of time.

Mr. GREENSPAN. That is correct.

The CHAIRMAN. And I think it is generally unnerving. I think it has been unnerving to the markets. I think it is unnerving to a lot of the major decision-makers in the country, business, private-sector decision-makers that I am speaking with and I am sure you are as well.

And the follow-on question I want to get to is this. There are still some people around that think that somehow there is a special kind of magic over at the Federal Reserve Board, that somehow the Federal Reserve Board, by doing a little bit of this and a little bit of that, can somehow avoid sharp and abrupt swings like this and perhaps upward increases in interest rates.

And it seems more and more apparent that your latitude—not just yours, but institutionally, the Federal Reserve's latitude, in the kind of new world economic and financial circumstances that you have just described, that the latitude of the Fed is less and less, and that you do not possess necessarily mechanisms that are available to you to suddenly counteract these world-wide trends that may be moving; and that you may not have, and in fact we may not have as a nation, the ability to keep interest rates where we might otherwise like them to be, if international events are working in such a way as to drive them up.

That is the way it appears to me. I would like to know whether that is the way it looks from within the Board, or whether we have policy options available to us where we could cut against these trends, more than we seem to be able to.

Mr. GREENSPAN. Mr. Chairman, you are raising a very important issue, which would take a long while to discuss. And I would like, frankly, to defer it for a short time, a few weeks, until I come back here to this committee with the testimony under the Humphrey-Hawkins Act.

At that time, I will try to address that particular subject in some detail.

The CHAIRMAN. Well, I am going to accept your request, although I think it is an issue that is upon us. And I think we have got to have some pretty direct debate about it, and not just at those time periods when we have the formal——

Mr. GREENSPAN. No, if it were not for the fact that I am due up here in a matter of days.

The CHAIRMAN. No, I understand. I understand. But I think, in the context of the budget debate which is now fully engaged, and a lot of other basic questions as to what the savings and loan recovery package is going to cost, and the impact on the housing market that Secretary Kemp has referred to, there are a lot of issues that relate to the hour-by-hour dynamics of the economy and how it is working right now, that relate to our ability to have some control over monetary policy.

And obviously, if we do not have any control over fiscal policy, we are probably not going to have much over monetary policy. But wrapping this new international context around it so that we educate ourselves and so that we understand what our maneuvering room is, what our latitude is, I think is a debate that ought not to be postponed for very long.

Mr. GREENSPAN. No. I would certainly agree with that. And let me just say that I am not as pessimistic as your concerns imply, and I would like to elaborate on that in some detail when I come back here in a couple of weeks or so.

The **Chairman**. Senator Garn.

Senator **Garn**. Thank you, Mr. Chairman.

I want to return to something that I think is extremely important, and that is what Senator Heinz had to say, that has been basically overlooked in this debate, in our desire to pass a bill last summer. These were concerns that were brought out by Senator Heinz, and I, and Chairman Riegle, and others, at the time, because the perception was that we should certainly clamp down on thrifts and have higher capital standards. And I agree with all of that.

Nevertheless, it seems to me that some provisions that we have put on are some of the reasons that you are having a hard time moving more rapidly, and we have all criticized your pace.

I think it goes beyond the QTL test. I think there is single-limit borrowing for one individual, other things of that nature that, however well intended, make a thrift less attractive for someone to take over and buy, and increases the cost.

So my open invitation at the beginning, if there are provisions of this kind that are causing you difficulties, I want to reiterate that you have to be more specific to identify these places in the legislation. Because we are going to keep pushing you on speed.

If part of the reason is the law that we have passed, then we want those provisions identified and specifically outlined as to why they are delaying the disposition of these assets.

I want to make that very specific, and request of you to identify those parts of the bill. Be candid with us, and let us know if there are changes we can make that will improve this situation.

Beyond QTL and others that I happen to think are too tight—and it is interesting, too, that while everybody likes to talk about waste, fraud, and abuse in the highly visible cases, still some of the problem is good, old fashioned interest rate mismatch in mortgage lending which these specialized institutions were supposed to do.

So I agree with you completely, Mr. Chairman. There is no way that we can keep the thrift industry going as it was set up in the 1930's. That is not possible. We would guarantee the failure of all of them, unless there is some flexibility to make profit in shorter-term ventures. You cannot lend long and borrow short forever. And you do not have to be too bright to figure out in the 1980's, while they were failing, when you had a 21-percent prime, and had fixed-rate, 30-year mortgages that were paying 6, 7, 8, and 9 percent, that there is no way out of that situation. You fail, unless you have some flexibility.

This brings me to another point. In the legislation last summer, one of the things that we did was to do away with high-yield or junk bonds. Under the Federal regulation, 11 percent of assets could go into them. The new law requires that they dispose of them within 5 years, and put them into a separate affiliate.

And while I personally disagreed with that, nevertheless, that is what we passed. But that is not as big a problem as requiring that these high-yield bonds be marked to market. So we have succeeded in taking some institutions that I am aware of that were profitable, met capital standards, and because of an accounting rule we are forcing them into failure.

And I fail to understand how, by accounting procedures, when we are trying to save the taxpayers' money, we are making decisions that force failures of otherwise at least reasonably healthy and profitable institutions.

So my question along that line is to Mr. Seidman, about FDIC's notice, on limiting purchase mortgage servicing rights to 25 percent of tangible capital.

Now, we went through this battle last summer, and decided, because we could not decide in the Congress to leave it up to the discretion of the FDIC of what percentage should be there—we tried various formulations, and were not successful. But I am afraid that this is another one of those, Bill, that limiting to 25 percent of capital certainly might result in the dumping of those assets and the depression of the very market that you have some concerns about.

That is exactly what happened with the high-yield or junk bond market. So at least this Senator's opinion is that that is too tight. You go to 25 percent, and your intent is to be careful and prudent, safety and soundness and all of that, but is that very act that appears to be prudent another one of those situations like the accounting changes, mark to market, that is going to actually depress the market and cause the opposite effect of which you are trying to accomplish?

Would you comment on that, please?

Mr. **Seidman**. It is a trade-off, as most of these things are, Senator Garn, where you get especially heavy concentrations in something that does have risk, and as an insurer you want to try to reduce those concentrations.

On the other side of course, we do not want to force institutions into insolvency, if in fact they have a way to get out of it.

First, this is out for comment, and we will be looking very carefully at the comments.

Senator **Garn**. You just got my comments.

Mr. **Seidman**. We have yours, and others.

First, it is phased in over a long period of time. So it is not going to be quite the same as the mark to market, which happens all today. This is phased in over really a 6½-, 7-year period. So it is not going to have that immediate effect.

Second, they do not have to sell these mortgage servicing rights. They can put them into a subsidiary or into an affiliate, and operate them there, and they will be allowed to comply. They will need additional capital to replace that.

We will be looking at that. All the regulators agreed that this was a reasonable position to put forward, but we will be looking at the responses to this before we make anything final.

Senator **Garn**. Well, if I could—my time is up—I would just quote the FDIC from a March 1989 Federal Register statement:

> The FDIC believes that mortgage servicing rights as a class of intangible assets generally possess characteristics that allow for their favorable treatment for supervisory capital purposes.

Then dropping down further:

> Even though intangible assets in the form of mortgage servicing rights will generally be favorably recognized for risk-based capital purposes, the deduction of part of these rights from tier one capital may be required if the carrying amounts of the mortgage servicing rights are excessive in relation to their market value or the level of banks' capital accounts.

And I agree with what you said then. Obviously, you have got to balance that. I am just concerned, I am not saying that you should not have any limits, that is not my point. I am just concerned in this propsoed rule-making that 25 percent is an awfully big discount, and there are some variables there that you ought to very carefully consider so that your intent of providing safety and soundness does not go in the other direction to put some out of business who otherwise would succeed.

Mr. SEIDMAN. And that is exactly why it is out for comment. We will undoubtedly hear from those who believe that this is going to put them out of business, and we want to study that carefully before we finalize the regs.

Senator GARN. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Heinz.

Senator HEINZ. Mr. Chairman, thank you.

I would want to just ask one question that is a little off the track, but it is only—I could argue that it is somewhat related to this. But it has to do with national savings, but it has to do with an issue that Alan Greenspan and I have discussed on many occasions. I apologize to my Chairman—I have been waiting for a little while, too.

It has to do with Senator Moynihan's proposal to cut payroll taxes. I have here a letter signed by 11 very distinguished economists, I am sure all of whom you know very well—Henry Aaron, Charlie Schultz, Alice Rivlin, and others—that says in substance, and I do quote:

> If enacted, the proposal would do serious harm to the economy. The immediate effect of the $55 billion cut in payroll taxes for 1991 that Senator Moynihan proposes would be to worsen the Federal budget deficit by an equivalent amount. To offset the potentially inflationary effects of an enlarged budget deficit, the Federal Reserve would have to increase interest rates, penalizing investment generally and long-term investments particularly. The higher budget deficit and increased interest rates would force the United States either to reduce investment at home or to increase borrowing from abroad, in either case, further eroding the already slow growth of American living standards.
>
> In short, cutting payroll taxes, or any other major tax, is the opposite of what is needed under current economic and budgetary conditions.

Would you agree with your colleagues?

Mr. GREENSPAN. The general conclusion, that is, that it is an inappropriate policy, I would agree with, and indeed said so at the Joint Economic Committee hearing yesterday.

Senator HEINZ. I apologize. I missed that. It did not get reported.

Mr. GREENSPAN. No, well, I would not expect that anyone would know that. But I just wanted to indicate that this is not a new statement.

Senator HEINZ. Very well.

Mr. GREENSPAN. The specific details of the economic impact of that particular proposal, I would like to pass on, in the sense that I think there is a great deal of complexity in what might happen. But I would certainly argue that Senator Moynihan identifies an important issue—namely, the question of not allowing the build-up in the Social Security Trust Fund to be reflected in a true increase in domestic savings, and therefore into domestic investment, which will create the physical wherewithal for those "baby boomers" who retire to have the physical resources to live upon.

I mean, he is correct in that.

Senator HEINZ. Chairman Greenspan, I happen to agree with you 100 percent on that. The Humphrey-Hawkins hearing this month will provide the best place to address this issue. I just want you to know that I do intend to be there, and to ask you to go into this subject at more length.

It is very timely, and you are a very thoughtful man on the subject. I appreciate your expertise.

Mr. Chairman, I want to ask a couple of questions. First, of John Robson, if he is not exhausted from sitting here this long——

Mr. KEMP. John is a very tough guy. He is durable, and he is ready to go right through the afternoon. [Laughter.]

Senator HEINZ. Well, unhappily, I have got a tough question for him.

John, you represent the Treasury Department. You may or may not recollect that during the conference on the S&L bill, that I together with Bill Seidman at the FDIC were trying to get our colleagues in the conference—and by the way, the Senate supported my position, and Senator Riegle supported my position—to give some important powers and standing to the FDIC, in order to both save depositors and to make sure that Congress did not throw the taxpayers out with the "bail"-water.

What I proposed, what the Senate backed me up on, was giving the Resolution Trust Corporation a priority over shareholders and creditors in getting money back in lawsuits against those who stole money from the S&L's.

Now, candidly, Treasury, in spite of my best efforts to get them to speak up, ran and hid in the weeds. Your Department was absolutely silent, never wrote a letter, never talked to anybody. If there was any support, it was invisible. Nobody could find it.

Now, I would like to know what efforts have been taken to go after the officers, directors, and others responsible for the losses at these S&L's. How many lawsuits have been brought to date, how much money the RTC expects to recover. I will also ask that of Bill Seidman in due course.

But I want to ask the Treasury: Do you now think that the RTC should be able to go to the head of the line, in front of shareholders and creditors, in getting money back for the taxpayers? Most thoughtful people, including of course the U.S. Senate, felt that that was good policy.

Mr. ROBSON. I was not involved in that debate here, and if I give you a reaction it will be right off the seat of my pants.

Would you let me respond to that in a more thoughtful way?

Senator HEINZ. Fine. As long as it is affirmative. [Laughter.]

Bill, you did back us on that. We ran into a little opposition I think from the House Judiciary Committee. They may have been talking to the so-called "plaintiffs' bar."

Do you want to try and answer the other part of my question, how you are doing on recoveries, and whether failure to get that authority is complicating matters? Tying things up in litigation?

Mr. SEIDMAN. It is pretty early, Senator Heinz, to give you any more than I guess what I said before. It is that the more powers that we have, and the further we are in the head of the line, the more money we are likely to recover.

Senator HEINZ. All right. Well, let's revisit that issue when you have harder data.

Mr. SEIDMAN. Yes.

Senator HEINZ. Let's not put this issue on hold. I happen to believe that the House made a terrible mistake in prevailing, simply because they were lobbied by special interests. They are always around, we know it, and they are going to be around for a long time. We have got to have the courage to say "No" to them.

John, this is another question for you, so that you stay alert here. There have been several lawsuits filed against the Government, claiming that the S&L bill in effect resulted in breaking contracts with those who acquired failed S&L's from the FSLIC.

The claim is that the FSLIC induced them to take over failed S&L's, but that the Government has not lived up to its side of the agreement, things like supervisory goodwill, and all that.

Do you know, or sense, whether there is a reluctance to deal with the Resolution Trust Corporation—and Bill Seidman can certainly chime in on this—because of a concern that the Government cannot be trusted to abide by its contracts, because a deal is apparently not a deal?

Is there any merit to the claims that prior contracts to acquire failed S&L's were broken? And if so, what is the potential cost to the taxpayers if the Government loses these cases?

Mr. ROBSON. I am not aware, Senator Heinz, of any specific instance where someone has said, "I am not going to deal with Bill Seidman, or the U.S. Government, because those guys do not keep their word." However, since Bill does the resolutions, he may have greater insight.

This issue, again, was thoroughly vetted at the time of the formation of the legislation. The argument against it was that regulatory standards change all the time. I ran a regulatory agency back in the middle 1970's, and we changed regulations on which people made substantial reliances, usually with some kind of a phasing period, not with the notion that you were locked in forever.

Senator HEINZ. Let me ask, Bill, then if he has any comment on this.

Mr. ROBSON. Sure.

Senator HEINZ. Bill, what are you running into?

Mr. SEIDMAN. Well, I think that it has not been a major factor, because in the transactions we are doing now, they are pretty straight transactions with no special provisions to induce people to do anything, either tax-wise or otherwise.

I have great sympathy for the people who in the past brought into these transactions under certain Government assurances. But we certainly learned from the tax law, which we referred to earlier, that the Government can change its mind, and it does not mind if someone acted based on the thought that that would not happen.

And I think, frankly, that that is appropriate. Because the Government, for instance, approves certain drugs for drug companies that they later find out cause cancer. They have got to revoke the approval. So I think that the Government has to do that.

Senator **Heinz**. Well, here is the basis of my concern. To the best of my knowledge, you have been unable to do a whole bank deal.

Mr. **Seidman**. Well, we will be announcing one this week.

Senator **Heinz**. Congratulations.

Mr. **Seidman**. Thank you. [Laughter.]

Senator **Heinz**. One out of 342, is it, 333?

Mr. **Seidman**. Our average is not high.

Senator **Heinz**. You know, it is a start, but you have got a ways to go to challenge George Brett, who by the way is also asking for additional money. [Laughter.]

My sense is, however, that there is a possibility that people are not lining up in droves to do whole bank deals, which will save you the most money. Possibly because they do not want to take the chance on the regulatory standards changing some more.

Is that a possibility?

Mr. **Seidman**. Well, I am sure that that is a factor. I do not think we have seen it as a major factor. I think most players in this game know that that is a risk of the business: You cannot rely on the Government.

Senator **Heinz**. And "they" is "us." And "they" is "us"; is that right?

Mr. **Seidman**. Yes.

Senator **Heinz**. Bill, let me ask you—and Senator Garn would probably put this a little differently than I would—last year, you were quite critical of some of the techniques used by the FSLIC in structuring some of their S&L resolutions.

Now, in light of your current experience with the RTC, are there any of these techniques—and I refer, for example, quite specifically, to open thrift assistance, or yield maintenance agreements—that you now believe would be useful to you, to include in the RTC's armory?

Mr. **Seidman**. That is a very good question.

I must say, I am——

Senator **Heinz**. I noticed you swallowing a little bit. Were those your words? [Laughter.]

Mr. **Seidman**. No, I am just much more sympathetic these days, now that Danny Wall is gone and I am up here all by myself, and from time to time I am much more sympathetic to his problems.

Senator **Heinz**. You did not criticize Danny Wall, you criticized the structure of the deals.

Mr. **Seidman**. That is right.

Senator **Heinz**. You criticized the nature of this kind of technique. So let's separate the personalities out of it.

Mr. **Seidman**. Right.

Senator **Heinz**. Your quotes indicate that you were critical of the resolutions, not Danny Wall.

Mr. **Seidman**. Well, really, what I was quoting was the GAO report on those transactions, which indicated that they had a number of perverse incentives. And I think that is still true.

I think that some of the income maintenance contracts really did prevent sale of assets, and because they were very long-term they could be very costly. So I do not have any inclination now that we need powers to go any length in that direction.

I do think that some of the kinds of transactions that involve shorter-term operations, where the incentives would be to sell rather than to hold on, and you of course would have to construct the contract in that way, could be useful.

Senator HEINZ. Bill, I am a little confused as to what you are saying, but I do not want to put you on the spot.

I do not understand what the shorter-term techniques are, I am sorry.

Mr. SEIDMAN. Well, basically, I do not favor doing what the Bank Board did in signing 8 to 10-year income maintenance contracts.

Senator HEINZ. So you are saying maybe 4 to 5 years, or something like that, would be appropriate?

Mr. SEIDMAN. No, I think that we would look much more at the kind of contracts that we did with NCNB, where they would have a put-back of assets over a 2-year period, something like that.

Senator HEINZ. I see. All right.

Thank you very much.

Mr. Chairman, thank you.

The CHAIRMAN. I want to try to conclude. We have run very late here, and partly because we have had 17 Senators participating today, which I think illustrates the importance of this issue.

I want to ask you right now to highlight any problems or glitches that exist that need to be ventilated, whether they are coordination glitches, policy glitches, money clitches. Is there anything that we need to know about that is holding back the normal turning of the wheels and resolutions that need to be done here?

Mr. SEIDMAN. Well, I would like to address that, Senator, simply by saying that the real question is, how can we save some money here for the taxpayer?

The best way we can save money is by keeping institutions out of the RTC, and not having to liquidate them. That is an area which I think needs some real exploration. And it particularly needs real flexibility, in terms of making decisions like that.

All the cost factors you have heard about are there, but the biggest one by far is, how many assets are we going to have to handle? How many of those assets are going to have to be dumped into real estate markets that are at this time weak in many areas of the country?

And so I think that that is an area that we need to explore. We will be exploring it with the Oversight Board. And I think it is an area where we are going to perhaps have to have considerable flexibility.

I would just add to that that there is some feeling that speed means closing down an institution, selling its deposits to somebody, and then dealing with the assets. Well, most of the loss is in the assets. So the fact that we resolve 40 or 60 does not mean that the losses are gone; 70 or 80 percent of the losses will still be there in the assets. And it is the sale of the assets that has to be accomplished, in order to cut out the losses.

Now, obviously, therefore, if you could devise methods that do not require such large amounts of assets to be put on the market—

and you saw the numbers; it is anywhere from $200 to $500 billion, and no one has any real idea at this time. So I think that is an area that needs to be addressed.

The only other thing I would like to say is, I would call attention to the fact that I think—and I am certainly not impartial—that the Oversight Board and the RTC have really accomplished a lot in 5½ months. I gave you a long list of these.

Having spent most of my life in the private sector, I would challenge any private sector institution to move much faster than that, given the constraints in place.

So with that, I will stop.

The CHAIRMAN. Let me ask you this. Do you have any policy requests that you feel you need to have answered, for you to move, that you have made to the policy board, that are awaiting disposition? Or, have all the requests that you might have made, if any, been acted on?

Mr. SEIDMAN. There are a couple that we have made that they have not acted on yet, but we only made them 1 week or 10 days ago. So I am sure they will be acted on in due course.

The CHAIRMAN. And you do not feel that you are being held up by that, in terms of carrying out your mission?

Mr. SEIDMAN. Well, I do not think it holds us up. Until we get the answers, obviously, we will not be able to do the kind of transactions we have indicated that we would like the flexibility to do.

The CHAIRMAN. Is there a good two-way street here—I will come to you just in a minute, Mr. Robson—but is there a good two-way street here? If the policy board decides that there are certain policies that need to be implemented, and it is sort of in the overarching guidelines for the RTC, I take it that you self-initiate whatever you think is needed and you send those rules and guidelines down to Mr. Seidman?

Does it work also the other way? If he feels that there is something that he needs, that he in turn is free to petition you? How does it work?

Mr. ROBSON. I think it is a more collaborative process than that, Senator Riegle. The cases that Bill cites are probably good examples of that. The rules that they have asked us to look at again are ones that deal with the length of these assets puts, which under the original policies of the Oversight Board were generally limited to 6 months.

Bill has now had a little mileage on his tires, and people have come back and said, "Gee, we think we would like a slightly more liberal approach to these things."

Originally, the RTC agreed with us on the 6-month rule. Now, they have looked at it, and so we are taking a look at it ourselves right now.

The CHAIRMAN. Right. And so is that one of the couple that are pending now?

Mr. ROBSON. Yes.

The CHAIRMAN. Is it worth taking a moment to mention what the other one might be?

Mr. ROBSON. The other issue is seller financing, which is how much does the Government finance the sale of assets or institutions? This is another area in which the Oversight Board has taken a fairly conservative view.

One of our fears is that these assets with long tails on them are going to come back and make Senator Garn's dream come true. That is we will be sitting here with these assets that we sold once, looking at them for the second time.

Our hope is to avoid that. Bill's point, and I think it is not to be ignored, is that there are some cases where we can make faster sales if we have a little more flexibility in these areas. We are going to try to find a balance in there.

The CHAIRMAN. Now, we think we have covered then the policy issues. What I am hearing both of you say is that there is a good flow back and forth on policy questions that arise. As the experience base grows, new questions come into focus.

There are really two policy issues now pending, from your vantage point, as far as asking them to take a look at it. They are looking at it, as you have just said, and you are going to make a judgment in due course, one way or the other, on that, as you are required to do, and that will give you the policy guidance.

In terms of money, I have heard you say, both of you, that you feel you have the cash you need today to do what you want to do today and tomorrow and the next day. I have heard you say that by the end of the month, the month coming, February, that there is going to be a need for additional cash resources, if you are going to continue to do what you need to do.

And you are nodding in the affirmative. Did I hear that right?

Mr. SEIDMAN. That is correct. Approximately the end of the month.

The CHAIRMAN. And I believe I understood you to say before that you are within a timeframe in terms of deciding how the additional working capital was to be gotten. That within that period of time, you will have made those judgments and presumably the wheels can turn, and whatever cash needs there are starting March 1 or thereafter, that the resources will be available. Is that a fair summary?

Mr. ROBSON. We expect to be providing working capital within Bill's timetable.

The CHAIRMAN. Yes. Now, are there any other snags that we need to know about, either from the point of view of the Oversight Board or the RTC itself, that need to be put on the table here?

Mr. SEIDMAN. No, we do not have—we have other things in process with the Oversight Board, procedures. We are dealing every day with them on lots of different kinds of operational issues.

The CHAIRMAN. I would expect that.

Mr. SEIDMAN. Yes.

The CHAIRMAN. I am really looking for sort of major snags that we need to know about in an oversight capacity, so that we can try to be helpful, because that is our intention, is to try to be helpful and implement the legislation.

Let me say this, that after the last oversight hearing on October 12, we sent questions to be answered for the record to the Treasury Department, Mr. Robson, as I am sure you know. Of course, you are acting as Secretary now.

We did not get the responses until January 26.

Mr. ROBSON. That is not acceptable to me, and it should not be acceptable to you.

The CHAIRMAN. I appreciate that, and I know that that is not the way you operate, in terms of our experience. And I have also raised this with Secretary Kemp, because we had a similar problem there, we did not get their responses until late in January as well.

What I have asked is that we have an understanding. We are not going to inundate you with questions or policy clarification letters, which we will send from time to time. I would like to have an understanding that we aim for a 30-day turnaround.

I would think that that is sufficient time. And if there is some extenuating circumstance that takes us beyond 30 days, I would like to know what it is. But can we have an understanding? We want to work with you, and I think that has been the pattern over the last year.

Mr. ROBSON. You have my promise to give that my best shot, Mr. Chairman.

The CHAIRMAN. Well, how good is your best shot? [Laughter.]

Mr. ROBSON. I do not see every letter that comes into the Treasury. But we generally try to turn our response around in 30 days.

The CHAIRMAN. Yes, well, here is what I am looking at. We want timely and full responses.

Mr. ROBSON. I agree with you.

The CHAIRMAN. If we are going to be good working partners, you know, and after a hearing we come back with material we have not covered, we have got to get a timely and full response. And I just want an assurance that we will get that.

Mr. ROBSON. You will.

The CHAIRMAN. And I have gotten that from Secretary Kemp.

Just one other thing I want to raise, and that has to do with Chairman Greenspan. What policy, if any, is the Oversight Board developing with respect to the problem of declining real estate values in New England and other parts of the country?

Mr. GREENSPAN. All of the policies are region-specific, obviously, because the markets differ from region to region. And I would suspect that, while there is no specific policy for New England, per se, the regional characteristics of each market, whether or not prices are strong, weak, whether there is an overhang, what the form of the vacancies are, are all relevant to the type of policies that will be addressed to any geographical area. And that will apply, obviously, to New England as well as any other place in the country.

The CHAIRMAN. Well, I can understand that in theory, but I guess, should I take your statement to mean that work is being done to look precisely at that problem and ones like it, where we have had a very major down-draft in values, and it obviously would affect the decisions that are going to have to be made here?

Mr. GREENSPAN. Well, I can say that certainly the Federal Reserve is looking at the New England real estate market in some detail, for a number of reasons, many of which I am sure you are aware.

That knowledge will flow over into the Oversight Board. And to the extent that Bill sees any use of it, we will certainly be glad to share it with him.

The **Chairman**. Let me say that several members have given me questions that they wanted answered for the record, Senator Kassebaum, Senator Cranston, many others. We will submit all of those to you. I am not going to ask you to stay longer now, to respond to questions directly.

I appreciate the work that is going on. It is difficult, at best. But I want to make sure that we have a very close and connected working relationshp, just as we did in developing the legislation and making sure that we are implementing it properly.

I think that this hearing today has been very constructive.

Mr. **Robson**. Thank you, Mr. Chairman.

The **Chairman**. Thank you all.

The committee stands in recess.

[Whereupon, at 1:30 p.m., the hearing was adjourned.]

[Response to written questions from witnesses follow:]

DEPARTMENT OF THE TREASURY
WASHINGTON

ASSISTANT SECRETARY

May 5, 1990

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing
and Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Please find enclosed responses to questions sent to Deputy Secretary Robson after the January 31, 1990 oversight hearing on the Resolution Trust Corporation.

I apologize for the later submission of these responses.

Sincerely,

B Harlow

Bryce L. Harlow
Assistant Secretary
(Legislative Affairs)

Enclosure

RECEIVED 5/4/90

Response to Senator Riegle's Questions

Question 1:

Please describe the manner in which the Department of the Treasury interacts with the Oversight Board. Which officials of the Treasury Department are detailed to the Oversight Board? What are their backgrounds and qualifications? Do any officials at the Treasury Department who are not detailed to the Oversight Board perform functions affecting the Oversight Board or the RTC? Do the other duties of the Secretary leave him with sufficient time to adequately address the complex issues faced by the Oversight Board?

Answer:

There are no officials of the Treasury Department detailed to the Oversight Board at this time.

The Secretary, as Chairman of the Oversight Board, has delegated to the Under Secretary for Finance and the General Counsel the responsibility for coordinating with the Oversight Board staff on a daily basis and coordinating with REFCORP. Each of these two officials, in turn, has staff who work on Oversight Board issues.

The Secretary is briefed regularly on policy developments, the RTC's need for funds, and the auditing of RTC activities. This process leaves the Secretary with sufficient time to concentrate on the most complex issues that face the Oversight Board.

The Treasury and the Administration believe the oversight structure established by FIRREA is necessary and workable. The Administration must have oversight over the actions of the RTC in order to protect the taxpayers' interests. After all, this agency's spending could be the single greatest determinant of the federal budget results over the next several years.

Question 2:

What steps are being taken to find a qualified replacement for Mr. Kearney, and who is in charge of the process? What is the time table for interviewing and selecting a permanent successor?

Answer:

Since Mr. Kearney's resignation, the Oversight Board has been actively searching for a permanent President and CEO of the Oversight Board. The Board will notify you as soon as it has made a final selection.

In the meantime, the Board is very fortunate that William Taylor, Director of Banking Supervision and Regulation at the

Federal Reserve Board, has agreed to remain as acting President and CEO of the Oversight Board.

Question 3:

The Comptroller of the Currency has addressed a letter to all nationally chartered banks concerning what appear to be systemic problems in real estate lending by banks. One of the apparent problems involves banks lending to developers to finance real estate projects in which the developers have little or no equity at risk. In enacting FIRREA, the House and Senate agreed to leave the matter of loan-to-value ratios up to regulatory discretion, but the Conference report directed the regulators to consider the limits that were in the Senate bill. What consideration have the OTS and OCC given to those limits, and how do they plan to proceed against these apparent systemic problems in real estate lending by thrifts and banks?

Answer:

The OCC with its recent letter to national banks and the OTS with its loan to value regulation have been trying to strike a balance between too little regulation, which may add to the drain on the deposit insurance funds, and too much restraint, which could restrict needed credit for the economy.

Currently there is considerable controversy over the OCC's letter to national banks which warned the bankers to be prudent in their real estate lending and to provide adequate reserves for these loans because of weaknesses in the real estate sector.

In addition, thrifts that have lent up to 100 percent of their capital to one borrower, as permitted by the Federal Home Loan Bank Board, have asked the OTS to provide a delayed effective date for the FIRREA provision on loans-to-one-borrower.

Some critics believe the regulators' recent actions are risking an overreaction by banks and thrifts which could result in a credit drought for commercial construction. This is an example of the dilemma confronting the regulators. They must insist that their institutions keep close track of their loans and establish reserves to anticipate failures. On the other hand they do not want to dampen lending unnecessarily, which could risk a recession.

In general, we believe that the regulators are following an appropriate approach, especially in view of the substantial losses experienced with real estate loans.

Question 4:

FIRREA made the Oversight Board ultimately accountable for the RTC's activities, but not involved in the day-to-day operations of the RTC. Recent statements and testimony indicate that the RTC is having to seek clearance from the Oversight Board on a broad variety of issues before it closes deals. Is this true? If so, will the Oversight Board continue to be so involved.

Answer:

The Oversight Board is not a participant and does not involve itself in specific case resolutions. We are not aware of any instance in which the RTC was required, before closing a deal, to seek clearance from the Oversight Board.

By law, one of the duties of the Oversight Board is to authorize the use of funds provided to the RTC by the Treasury and REFCORP. At no time has the RTC been without the funding needed to operate.

As for matters of policy, the Oversight Board has responded promptly to requests from the RTC. One prominent example was a request from the RTC, dated January 19, 1990, for a revision in Oversight Board policies on asset puts and seller financing. The Board undertook a review of the policies in the Strategic Plan, which had been adopted less than one month earlier, and even though these are complex issues acted on the requests on February 23 and March 8 respectively.

Question 5:

From the standpoint of sound financial regulation, is there any reason why thrift institutions should be subject to a more lenient limit on loans-to-one-borrower than commercial banks?

Answer:

The Administration knows of no reason why thrift institutions should be subject to a more lenient limit on loans-to-one-borrower than commercial banks.

Congress amended FIRREA to subject thrifts to the same loans-to-one-borrower limit that applies to national banks -- in general, these loans may not exceed 15 percent of capital. This provision became effective upon enactment of FIRREA. However, many thrifts had loans to one borrower equal to 100 percent of capital, the limit that had been set by the FHLBB. Some of these thrifts and their borrowers have asked for a delayed effective date so that business will not be disrupted.

The OTS has recently issued an interim regulation implementing the loans-to-one-borrower provision which provides for a number of transition provisions other than a delayed effective date. These include: (1) current loans that exceed the new limit can be renewed if no new funds are advanced and a new borrower is not substituted for the original borrower; and (2) thrifts that meet their fully phased-in capital requirements may make loans to develop domestic residential housing units up to the lesser of $30 million or 30 percent of capital and surplus. The regulation also invites comment on whether other forms of transition relief may be legally permitted.

The Administration believes that the transition provisions included in the OTS regulation will help with the implementation of the provision and that no legislative changes are necessary at this time.

Question 6:

The Federal Home Loan Bank Board's call reports provided only limited information on the extent to which thrift institutions held assets that could be used to satisfy the qualified thrift lender test. What steps has the OTS taken to ensure that adequate data are collected?

Answer:

The OTS has told Treasury that it is currently revising its thrift financial report so that it will be able to easily identify institutions that pass the QTL Test, when that test becomes effective on July 1, 1991. The OTS will be glad to give you more detailed information on the information it has available from its current call report.

Question 7:

What action has Treasury taken on the Office of Thrift Supervision's proposed regulations relating to early intervention, marginal capital, and the interest rate-risk component of thrift capital standards?

Answer:

Treasury, after approving the OTS's general risk-based capital regulation last fall, asked the OTS to provide more information on the estimated impact on the industry of the proposed interest rate-risk regulations. The OTS recently provided this additional information and is reviewing its proposal.

We also understand that OTS is currently reviewing and revising its early intervention and marginal capital regulations.

Question 8:

In enacting FIRREA, Congress provided for a SAIF exit fee and a BIF entrance fee to be imposed when a deposit transfer is performed in conjunction with the sale of a failed thrift. In using what is known as the "paying agent" method of resolving a thrift failure, however, the RTC is technically liquidating thrifts -- thereby avoiding the statutory exit and entrance fees -- but as a practical matter the transaction has exactly the same effect as a deposit transfer. Why has the RTC found it necessary to adopt the paying agent method instead of sticking with the forms of resolution Congress contemplated in enacting FIRREA?

Answer:

The use of paying agents is a way of administering liquidation when that is used as the method to resolve the failure of a financial institution. The FDIC traditionally has used paying agents to make insured deposits available to account holders of banks undergoing liquidation. The transfer of insured deposits to a paying agent spares the FDIC from the burden of paying off depositors directly and, at the same time, causes minimum disruption to the depositors' financial affairs. Paying agents generally pay a premium for the right to perform this function, at which they have a proven record of efficiency.

The RTC has adopted the paying agent method to pay off the depositors of thrifts that are being liquidated in recognition of the benefits the use of such agents has to offer. Under an interim rule issued by the FDIC and agreed to by Treasury in March, 1990, when a bank becomes the paying agent for a liquidated thrift it is liable for exit fees from SAIF and entrance fees to BIF, but pays the fees out of the premium bid for the insured deposit transfer. The bank's liability for exit and entrance fees to the insurance funds is limited to the amount of the premium. The portion of the premium that remains after these fees have been paid is allocated to the RTC.

Question 9:

Some of the Administration's original estimates have not been accurate for the initial 6 months after FIRREA. For example, the Administration projected REFCORP's borrowing costs would begin at 8.25% and decrease to 7.25%. In fact, the latest REFCORP issue was priced at 8.6%. Will the Oversight Board prepare a new estimate of the cost of the program to the taxpayer? What will the estimate be if interest rates remain constant? What will the estimate be if SAIF-insured deposits do not grow but remain constant?

Answer:

The Administration's August 1989 projections of REFCORP's borrowing costs were based on a spread over the estimated general level of interest rates that was used in the President's budget. The Treasury Department projected REFCORP bonds would be priced to yield 25 to 30 basis points over Treasury securities of comparable maturities. So far, all REFCORP issues have gone to market at the spreads initially estimated. Nonetheless, REFCORP's overall borrowing costs have been higher than predicted because the general level of interest rates has been higher than expected at the time the projections were made.

In answering the question about whether the Oversight Board will prepare a new estimate, we would differentiate between net losses and budget outlay estimates. The Oversight Board has clear responsibility for reviewing and updating the estimate of net losses -- i.e. whether the $50 billion provided in FIRREA is enough. We would expect the Oversight Board to have more of a secondary role in estimating budget outlays, with the Office of Management and Budget taking the lead.

In its January testimony, the Oversight Board noted the uncertainties in estimating the ultimate cost of resolving failed thrifts and conceded the possibility that $50 billion will prove inadequate. The Board committed to share useful and credible data with the Congress and to request additional resources in a timely manner "when we become convinced that [they] are necessary."

Question 10:

Secretary Brady told this Committee last year that he would work to have the RTC adopt ethics rules that would prevent not only criminal conduct, but also "unseemly" behavior. The RTC plans to spend $2 billion in 1990 on operating expenses. Eighty percent of that ($1.6 billion) will be spent on contractors from the private sector. Is Secretary Brady satisfied that the Oversight Board and the RTC have proposed rules that will safeguard the taxpayer so that the $1.6 billion will be spent wisely, without fraud or favoritism?

Answer:

In accordance with FIRREA, the Oversight Board and the RTC in February 1990 issued a final rule on the qualifications of, ethical standards of conduct for, and restrictions on the use of confidential information by independent contractors. The final rule not only incorporate the mandatory prohibitions required by FIRREA, but also establishes a system under which the RTC has adequate information and discretion to safeguard the integrity of the contracting process.

The intent of the rule is to assure the RTC access to private sector services (to the extent that such services are available and their utilization is practicable and efficient), while requiring independent contractors to observe ethical standards which preserve the integrity of the system. The Oversight Board is satisfied that RTC's qualification process under the minimum standards of competence, fitness, and experience the rule promulgates for independent contractors will ensure that taxpayer funds expended on such contractors will be spent for the public good.

Question 11:

The Oversight Board is charged with monitoring the RTC's compliance with its strategic plan. Will the Oversight Board prepare an analysis comparing the actual cost of specific transactions to the projected cost of liquidation, after all the assets from that particular thrift have been sold or otherwise disposed of by the RTC?

Answer:

In the disposition of a thrift, the RTC is required by FIRREA to prepare an analysis comparing the projected cost of liquidation to the projected cost of an assisted sale of that thrift as a going concern. The RTC may conduct an assisted sale of a thrift only if the analysis shows that such a sale would cost less than liquidation or if a finding is made that the thrift renders essential services to its community.

Under the provisions of FIRREA, the Oversight Board has the duty and the authority to review periodically the "overall performance" of the RTC. As part of that review process, we would expect to evaluate overall RTC performance against projected results, which would generally include a comparison of actual versus projected costs. The Oversight Board will also evaluate audits by the Inspector General, as the law requires.

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

ALAN GREENSPAN
CHAIRMAN

April 16, 1990

The Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

I am enclosing responses to your written follow-up questions regarding my testimony on January 31, 1990 at the Committee's oversight hearing on the Resolution Trust Corporation. If I can be of further assistance, please let me know.

Sincerely,

Alan Greenspan

Chairman Greenspan subsequently submitted the following in response to written questions from Chairman Donald W. Riegle, Jr., in connection with the hearing held on January 31, 1990.

Q.1. The RTC's strategic plan generally lacks specific goals, such as a target number of thrifts to be sold by the end of the year. As a former consultant, isn't it your experience that a meaningful strategic plan usually contains more objective measurement standards than the RTC's plan does?

A.1. The purpose of the plan, in the view of the Oversight Board, is to set a strategic framework for operations by the RTC. It seeks to establish broad policies to guide the RTC in responding to a variety of circumstances, as well as to the multiple objectives set out in FIRREA. This seems entirely reasonable and not inconsistent with the goals of strategic planning.

As a general rule, strategic plans try to assess the environment and lay plans for operating within that environment. Given the uncertain conditions in which the RTC must operate, the absence of numerical targets in the RTC plan seems entirely understandable.

At this point, it is difficult to set realistic, long-term targets of the type sometimes found in strategic plans in the private sector. Quantitative performance targets will be set out more fully in the annual operating plan and budget that the RTC will be submitting to the Oversight Board for approval, as called for in the strategic plan.

Q. 2. Capital standards are supposed to provide a buffer between thrift losses and the taxpayers. Last year, when the FDIC and the OCC disagreed on the appropriate capital standard for banks, the Federal Reserve proposed a compromise between the two positions. Are you confident this middle ground position is adequate? Have the OCC and the FDIC accepted it?

A.2. The Federal Reserve has proposed that the risk-based capital standard be supplemented by a minimum ratio of 3 percent Tier 1 capital (primarily common stock and permanent preferred stock) to total assets. A number of points should be made concerning this leverage ratio and how it is viewed by the banking agencies. First, banking organizations would be expected to meet the 8 percent risk-based standard as well as the proposed minimum leverage ratio. Second, the proposed Tier 1 leverage ratio represents a strengthening of capital standards since this definition of core capital excludes goodwill, subordinated debt, and loan loss reserves -- the latter representing amounts set aside for unidentified future losses.

Finally, both the risk-based standard and the proposed leverage ratio are minimums. The Federal Reserve expects most banking organizations to be well above minimum supervisory capital ratios. This is particularly true for organizations with any financial, managerial or operating weaknesses; organizations facing unusual, abnormal, or undue risks; and organizations experiencing or anticipating significant growth. The Board has indicated that such organizations should generally operate with capital levels at least 100 to 200 basis points above stated minimums. Thus, the practical effect will be that banking organizations expanding or those facing unusual or undue risks will be expected to have risk-based ratios in the range of 9-10 percent and Tier 1 leverage ratios in the range of 4-5 percent.

All of the federal banking agencies share a common view that adequate capital is a critical factor in promoting bank soundness. The OCC and the FDIC, together with the Federal Reserve, have jointly adopted risk-based capital guidelines that take effect on an interim basis at the end of 1990 and on a final basis at the end of 1992. Moreover, all of the agencies recognize the need to retain a minimum capital-to-total assets leverage standard. In this regard, the OCC has also proposed a minimum Tier 1 leverage ratio of 3 percent. At this point, the FDIC has not proposed a new leverage standard; rather, it is retaining for the time being the existing primary capital leverage ratio. It is our understanding that the FDIC favors supplementing any 3 percent Tier 1 leverage standard with an additional cushion which could take the form of subordinated debt. This approach is generally consistent with the Federal Reserve's view concerning the need for an additional 100 to 200 basis point cushion over its proposed minimum Tier 1 leverage standard. More broadly, the banking agencies recognize that supervisory capital standards are minimums and that, in general, most institutions, especially institutions experiencing difficulties or facing unusual risks, should operate with capital positions well above minimum supervisory levels.

Q. 3. Profit margins on residential mortgage lending are often said to have narrowed in recent years.

(a) Is that true? If so:

(b) Does the evidence indicate that the narrowing resulted from thrift institutions' increasing their mortgage lending in order to satisfy the QTL test? Or did the narrowing result from other factors, such as high interest rates paid by sick thrifts and competition from mortgage bankers and secondary mortgage-market agencies?

(c) Did the narrowing occur before the current QTL test was enacted in August 1989?

(d) Has the spread between mortgage interest rates and thrifts' cost funds improved since FIRREA was enacted?

A.3. Mortgage lending has two components: (1) loan origination and (2) loan financing or investing. Profit margins in the mortgage origination industry have narrowed since 1987, judging from employment trends in the mortgage banking industry and the withdrawal of a significant number of firms from that line of business. The years 1986 and 1987 were unprecedented in the volume of residential mortgages originated, with much of the surge attributable to refinancings of existing loans. Some retrenchment in the mortgage origination industry has not been surprising as the volume of business has returned to more sustainable levels and the industry has shed some of its excess capacity. In mortgage investing, the trend, if any, in profitability is not apparent. While some thrift institutions and other investors in mortgages have suffered losses, in many instances the specific business practices of the investors have been the cause, rather than a market-wide reduction in the profitability of mortgage investing.

Regarding the spread between mortgage interest rates and thrifts' cost of funds since the passage of FIRREA, the average contract interest rate on new commitments for conventional fixed-rate mortgages with 80 percent loan-to-value ratios at major institutional lenders was 9.96 percent during the week ending August 11, 1989. For the week ending March 2, 1990, this rate was 10.23 percent. The national median cost of funds ratio for SAIF-insured institutions was 8.08 percent for the month of

August, 1989. For December (most recent available data) the ratio was 7.92 percent.

Q.4. FIRREA made thrift institutions subject to the same 15-percent limit on loans to one borrower as applies to national banks. From the standpoint of sound financial regulation, is there any reason why thrift institutions should be subject to a more lenient limit on loans to one borrower than commercial banks?

A.4. A limit on loans to individual borrowers represents a reasonable and appropriate prudential restraint for thrifts as well as commercial banks. Such a limit fosters diversification and minimizes the likelihood that the financial problems of a single borrower can threaten the viability of the lending institution. Individual borrower limits have long been an important and useful component of the bank regulatory framework. Both competitive equity and prudential considerations argue strongly for the application of consistent individual borrower limits to thrift institutions and commercial banks.

Q.5. The Comptroller of the Currency had addressed a letter to all nationally chartered banks concerning what appear to be systemic problems in real estate lending by banks. One of the apparent problems involves banks lending to developers to finance real estate projects in which the developers have little or no equity at risk. In enacting FIRREA, the House and Senate agreed to leave the matter of loan-to-value ratios up to regulatory discretion, but the Conference report directed the regulators to consider the limits that were in the Senate bill. What consideration have you given to those limits, and how do you plan to protect against these apparent systemic problems in real estate lending by banks?

A.5. Borrower equity or net worth, as well as the borrower's income or cash generating capacity, are critical factors in determining the borrower's ability to repay a loan. With regard to real estate loans, the margin of collateral in excess of the amount of the loan, which is a function of the loan-to-value ratio, reflects the borrower's stake in the transaction and represents a cushion of protection to the lender. The interplay of all of these factors determine the quality or soundness of a real estate loan.

Loan to value ratios may have some merit as possible supervisory or regulatory guidelines, and, in some situations, Federal Reserve examiners employ broad rules-of-thumb for commercial real estate that are not inconsistent with some of the ratios mentioned in the Conference report. However, it is important to keep in mind that loan-to-value benchmarks cannot substitute for a sound analysis of the entire array of factors affecting credit quality. For example, it may well be prudent to lend up to 80 percent against the value of collateral owned by a borrower with a high net worth and strong income producing capacity. In contrast, it might be unwise to loan a similar amount against the same collateral if the collateral is owned by a financially weaker borrower. The key point is that the condition of a loan and, therefore, the risk to the lender is determined by a number of considerations beyond the simple loan-to-value ratio. The Federal Reserve addresses real estate lending problems during on-site examinations at which time loan-to-value ratios, as well as borrower net worth and guarantees, cash flow and income, and alternate sources of collateral, are carefully assessed to determine the quality of real estate loans. Examiners also review loan underwriting and approval standards in order to make an overall judgment on the lender's risk exposure. Weaknesses in any of these areas could result in examiner criticism, loan classification and, if significant, additional reserves and capital requirements.

In addition to the procedures for assessing real estate loans employed by each of the banking agencies, we believe that loan-to-value ratios, together with a number of other real estate matters, would be appropriate topics to be addressed by the Credit Standards Advisory Committee established by Title XII of FIRREA. The Federal Reserve's representative on this Committee has been instructed to explore with the other members the merits of placing these matters on the Committee's agenda.

Q.6. FIRREA requires the FDIC to determine to what extent a federally insured thrift institution may rely on purchased mortgage servicing rights to satisfy the tangible capital requirement. The FDIC has been criticized for proposing a limit on the use of such rights to satisfy that requirement. Some critics assert that the FDIC's proposal would discourage bank holding companies from buying thrifts.

(a) Do you believe that the FDIC's proposal would discourage bank holding companies from acquiring thrifts?

(b) Should a thrift institution be free to rely entirely on purchased mortgage servicing rights or other intangible assets in meeting capital standards?

(c) The Board has required bank holding companies that acquire thrift institutions to maintain the thrift's capital at or above a given level. The Board's consolidated holding company capital standards also tend to encourage the holding company to maintain the thrift's capital. Would the FDIC's proposal require the thrift to have more tangible capital than would be called for under the Board's capital conditions and holding company capital standards?

A.6. Under generally accepted accounting principles, mortgage servicing rights are considered to be intangible assets. The value of mortgage servicing rights is subject to a considerable degree of uncertainty, in part because, unlike loans, mortgage servicing rights do not represent a contractual claim with a fixed principal amount due upon maturity. Given the characteristics of intangible assets, the banking agencies have generally discouraged or limited the role of mortgage servicing rights in capital for the purpose of determining compliance with regulatory capital standards. For general supervisory purposes, the Federal Reserve expects mortgage servicing rights not to exceed 25 percent of an institution's core capital. In the special case of organizations undertaking significant expansion, including the acquisition of thrift institutions, the Federal Reserve expects acquirors to maintain capital positions well above minimum standards without significant reliance on intangible assets. In evaluating major expansion proposals, the Federal

Reserve assesses the capital ratios of the firms involved going into the transaction, as well as, in the case of a merger or acquisition, the pro forma capital ratios of the resulting firm. In this connection, the Federal Reserve takes into account tangible capital ratios (that is, ratios net of all intangibles, including mortgage servicing rights), stated or book capital ratios (without adjusting for intangibles), and the volume, nature, and quality of any intangible assets.

In our view, limitations placed on intangible assets for capital purposes, particularly when evaluating mergers and acquisitions, helps to assure that the resulting or acquiring institutions will be more strongly capitalized. This also helps to ensure that mergers or other types of restructuring transactions lead to a stronger, rather than a weaker, banking system. It would simply not be appropriate to attempt to resolve the thrift situation or encourage thrift acquisitions by lowering capital standards; nor, given the characteristics of intangible assets, would it be appropriate to allow intangible assets to be included in bank or thrift capital without limitation.

As the question indicates, the FDIC policy on mortgage servicing rights is still in the proposal stage; therefore, it is difficult to be precise at this point on how the proposal would work. As we understand the FDIC proposal, subsidiaries of depository institutions could under some circumstances have a large volume of mortgage servicing rights provided certain conditions were met. In theory, at least, this provision appears to place no overall limit on the percentage of the depository institutions' consolidated capital that could be made up of mortgage servicing rights. If this is correct, then it is unlikely that the FDIC proposal would require more tangible capital than under Federal Reserve procedures since the Federal Reserve generally evaluates and limits goodwill on a consolidated basis as well as for individual subsidiaries.

RTC
Resolution Trust Corporation

MAY 9 1990

April 27, 1990

Dear Mr. Chairman:

Thank you for your letter forwarding additional questions in connection with the hearing held on January 31, 1990. We are pleased to enclose responses to those questions for the hearing record.

We hope this information is useful. Please let us know if we can be of further assistance.

With best wishes.

Sincerely,

L Wm Seidman

L. William Seidman
Chairman

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Enclosure

550 17th Street, NW ■ Washington, DC 20429

MAY 9 1990

RTC RESPONSES TO QUESTIONS FROM CHAIRMAN RIEGLE IN CONNECTION WITH THE JANUARY 31, 1990, HEARING BEFORE THE SENATE BANKING COMMITTEE

Q.1. The number of thrifts sold by the RTC during the fourth quarter of 1989 was significantly smaller than the number sold during the third quarter. Why has the pace of RTC resolutions been slowing down?

A.1. Although the number of thrifts resolved in the fourth quarter is less than the number resolved in the third quarter, the amount of assets handled was substantially greater in the fourth quarter. Many small thrifts were resolved in the third quarter, while several larger thrifts were dealt with in the fourth quarter. Moreover, the transactions utilized in the fourth quarter were often more complicated than the simpler transaction formats (many insured deposit transfers involving few if any assets) used predominantly in the third quarter. Furthermore, it takes time for larger more complex transactions to proceed from the initial resolution stages to final disposition. As the process continues, work begun in these earlier periods to move institutions into the resolution pipeline will mature into resolution results in the period ahead. However, there may be small delays as our new expedited resolution process is implemented.

With respect to the thrifts already in the RTC, we contemplate moving 140 of those institutions by June 30 of this year and a substantial part of the rest by year end. Of these, about 50 will be closed down without selling them, since closure will be less costly than the likely results of a sale. In addition to these thrifts already in the RTC, implementation of the new expedited resolution program will result in the sale of other thrifts before they are placed in the RTC.

Q.2. Your prepared testimony indicates that your review of the 1988 deals will take until August 1990. Is there anything that can be done to save the taxpayer some money between now and August?

A.2. The RTC will report to the Oversight Board and the Congress on its review of the 1988 FSLIC assistance transactions at the end of August. Until that report has been reviewed, the RTC does not expect to renegotiate the transactions.

The RTC expects that while "savings" may not be realized on most of the 1988 FSLIC assistance transactions prior to August 1990, "costs" associated with some transactions will be restricted. This expectation is based on the fact that some of those assisted institutions or their parent companies have already been or are expected to soon be placed under RTC conservatorship. Once an institution is under RTC conservatorship, the FDIC and RTC may restructure the terms of the assistance as they deem appropriate. At such point, the costs to the U.S. taxpayer of yield-maintenance, capital-loss coverage, and loss-sharing are effectively set.

Q.3. I read that the RTC has formed a special task force to examine fraud at failed thrifts. In 1989, the GAO reported it found fraud and insider abuse at every failed thrift in a sample it examined. Are you finding the same pattern of abuse? Has the Justice Department cooperated fully with you in your examination of fraud at failed thrifts?

A.3. The RTC has established an Office of Investigations in Washington and a corps of investigators throughout the country to conduct investigations in each of the RTC controlled thrifts. They will identify the individuals who caused thrift insolvencies through reckless mismanagement, fraud or criminal conduct. Investigators will help determine whether and what sort of litigation should be initiated to recover fraudulently or recklessly misappropriated assets. In practice, RTC investigators will be involved initially and throughout the civil litigation, supporting the attorneys. RTC investigators will assist the FBI and U.S. Attorneys in prosecuting individuals who benefitted personally at the taxpayers expense.

The investigator's initial task after the RTC is appointed conservator of an insolvent thrift is to conduct a preliminary investigation of the facts leading to insolvency and to prepare a "Preliminary Findings Report". As of March 6, 277 preliminary findings reports had been completed, representing 70 percent of the 397 thrifts under the RTC's control.

On August 9, 1989, when FIRREA was signed into law, there were 262 thrifts under conservatorship. Since then 135 have been added and 50 resolved, leaving 397 thrifts as of March 10.

Based on our survey of the 277 thrifts for which preliminary findings are available, we estimate:

- Slightly over 60 percent of the thrifts were subjected to serious misconduct by insiders and/or the fraudulent conduct of affiliated outsiders, usually borrowers;

- Roughly 50 percent (138 thrifts) have had apparent criminal misconduct referred to Justice;

- In roughly 50 percent, (138 thrifts) insider abuse and misconduct contributed significantly to insolvency; and

- About 15 percent (42 thrifts) were apparently involved in irregular and possibly fraudulent transactions with other financial institutions.

Our survey revealed instances of insider abuse and misconduct ranging from embezzlement and simple loan fraud to complex conspiracies and schemes to defraud the institutions. We noted a predominance of lavish lifestyles, plush accoutrements, expensive autos, artwork, airplanes, and compensation incentives benefitting insiders at the expense of stockholders and depositors. Many of the complex schemes involved over-valued property that was swapped several times between borrowers or among various S&L's. These land flip schemes created false values on which loans were made and generated excessive fees that were parcelled out to appraisers, brokers, developers and other participants in the scheme, including insiders of the S&L's. We are pursuing several instances of unauthorized trading in mortgage backed securities, junk bonds and other financial instruments where insiders benefitted personally at the expense of the institution. A look at the regional distribution of thrifts for which Preliminary Findings Reports were completed is informative. Abuses are more prevalent in the Southwest and Southern California with more recent problems stemming from the Northeast and Florida. The RTC's Central Region, comprising Arkansas and eleven midwestern states, reports far and away the lowest percentage of thrifts exhibiting fraud and abuse--less than 40 percent.

You asked about the cooperation of the Justice Department in the RTC's investigation of S&L fraud. Our survey revealed no major bottlenecks or problems with the response of U.S. Attorneys to RTC criminal referrals. The overall consensus was that the Justice Department's performance in responding to thrift cases had improved substantially in the past twelve months[1] and that the addition of new FIRREA resources would further improve the process. Because our limited investigative resources are scarce as of now, we are concentrating on about a dozen very significant cases of fraud, abuse and misconduct. Our experience with the FBI and U.S. Attorneys' offices in these high priority cases is extremely positive.

7The Justice Department is aggressively pursuing each of these matters and has allocated sufficient resources to carry out a speedy prosecution. Coordination has been excellent. As new cases arise, we are attempting to coordinate our efforts from the outset not only with criminal prosecutors but with other interested agencies, such as the OTS, SEC, IRS, State and local prosecutors and regulators. With the coming of the new FIRREA resources and the level of cooperation we have experienced to date, we see no reason why any major criminal cases involving RTC thrifts with clear prosecutive merit should not be vigorously pursued and successfully prosecuted.

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[1] Although the RTC has existed for approximately 8 months, many RTC investigators transferred from FDIC's Division of Liquidation and drew upon prior experience in responding to this question.

Q.4. One criticism that has been leveled at the RTC is that its sales force has little marketing experience and does not know how to sell property efficiently. What is your response to this complaint? How many marketing people do you have? What is the size of your sales force? How are you selling the properties in your inventory? What sort of incentives do you have in your compensation structure? Who is the head of your sales division and what is his or her background?

A.4. To ensure the properties of the RTC are marketed aggressively, effectively, and efficiently, the RTC has established marketing policies utilizing extensively the private sector's industry of real estate professionals including appraisers, brokers, sales agents, marketing consultants, and auction firms. The RTC has established a marketing function within each of its national, regional, and consolidated offices employing demonstrated real estate professionals. As such, the sales force necessarily consists of RTC professional employees identifying, retaining and directing the nation's premier, most experienced, and most talented industry experts. In summary, a smaller number of RTC employees will oversee a large number of private sector marketing and sales professionals. The total number of professionals needed will vary with the amount and complexity of the property to be sold.

A comprehensive nationwide marketing strategy implementing innovative conventional sales programs, portfolio (bulk) sales programs and the real estate auction alternative is being developed to efficiently sell the property within our inventory. A private sector advisor will be used extensively in finalizing this policy. The incentives within our compensation structure include sales commissions consistent with industry standards and an asset management compensation structure specifically intended to prioritize disposition.

The RTC's sales division is headed by Mr. Lamar C. Kelly, Jr., Director, Asset and Real Estate Management Division, who possesses outstanding credentials for the position he holds, having 21 years of analyzing and disposing of real estate for the FDIC at various levels, including Regional Director of the San Francisco region.

Q.5. A January 24, 1990 Wall Street Journal article indicated that the FDIC hired an appraiser who was sued by the FSLIC for engaging in a civil conspiracy with savings and loan officials to make over $14 million in bad loans. Without commenting on the merits of the litigation, I find it puzzling that the person at the FDIC who hired this appraiser said that he did not know about the lawsuits and further said that the appraiser in question is now "very ethical and very conservative. . . . What he was in 1982 and 1983, I don't know." One provision of Section 501 of FIRREA states that RTC shall not hire persons who caused "a substantial loss to Federal deposit insurance funds." Can you assure this Committee that the minimum qualifications for contractors and employees will be enforced?

A.5. According to the Director of the Division of Liquidation, the individual referred to in the article is currently a review appraiser with the FDIC's Division of Liquidation. The individual was a junior staffer of Cushman and Wakefield assigned to the engagement which resulted in the lawsuit. Cushman and Wakefield settled out of court. There remains no outstanding judgment against this individual of which we are aware. The remaining lawsuits appear to be against the borrowers and/or the savings and loan officials.

The FDIC has investigated the facts and circumstances surrounding the FDIC employee mentioned in the article and is satisfied that he meets the minimum competency, experience, integrity, and fitness requirements as required by the Employee Responsibilities and Conduct Regulations, jointly adopted by the RTC Oversight Board and the RTC Board of Directors on February 5, 1990. FIRREA gives the RTC greater hiring and firing latitude than is allowed government wide; thus, enforcement of the statute will allow us to terminate employment of those persons who are found not to meet the statutory requirements found in FIRREA.

Q.6. In your prepared testimony, you state that while you have spent $9 billion on resolutions between August 9 and the end of last year, you will spend $22 billion this quarter alone. How much did you spend in January and what is your projected spending on thrifts currently up for bid that are projected to close during this quarter?

A.6. On the five resolutions that occurred in January 1990, the RTC provided funds amounting to $1.7 billion (which included $100 million of RTC advances). In addition, the RTC spent $524 million to replace high cost funds, and $22 million to meet emergency liquidity requirements.

For the entire first quarter of 1990, the RTC provided funds amounting to $6.1 billion (which included $1.4 billion of RTC advances) to resolve a total of fifteen institutions.

Q.7. How much cash has the RTC, and thrifts in receivership, (but not thrifts in conservatorship) collected from illiquid assets (assets not in the category of assets transferred in a "clean thrift" transaction)?

A.7. We have collected $258,861,300 in principal collections and $63,786,700 in interest collections for a total of $332,648,000 from assets in receivership as of 2/2/90.

Q.8. FIRREA made the Oversight Board ultimately accountable for the RTC's activities, but not involved in the day-to-day operations of the RTC. Recent statements and testimony indicate that the RTC is having to seek clearance from the Oversight Board on a broad variety of issues before it closes deals. Is this true? If so, will the Oversight Board continue to be so involved?

A.8. FIRREA requires the Oversight Board, in consultation with the RTC, to establish overall strategies, policies and goals for RTC activities. Because the Strategic Plan was under development until the end of December, there were a number of issues at that time that needed Oversight Board approval before deals could be consummated. Some of these issues were, for example, the RTC financing of asset sales, the use of RTC funds for open thrift assistance, and private sector usage.

FIRREA further mandated that the Oversight Board provide an ongoing review of RTC overall financial goals and budgets as well as periodic review of performance, management activities, and internal controls.

As the Oversight Board and the RTC gain in experience, additional issues will continue to evolve. Additionally, once the National and Regional Advisory Boards become fully operational, they will be a valuable source for providing input.

Q.9. FIRREA makes thrift institutions subject to the same 15-percent limit on loans to one borrower that applies to national banks. Because the limit is based on "unimpaired capital and unimpaired surplus," it prevents tangible insolvent thrifts from making new real-estate development (ADC) loans of more than $500,000. Some of these thrifts argue that the limit, by denying such thrifts the high rates of return available on ADC loans, will cause such thrifts to fail and increase the long-term cost to the Government.

From the standpoint of sound financial regulation, is there any reason why thrift institutions should be subject to a more lenient limit on loans to one borrower than commercial banks?

A.9. The FDIC fully supports the principal of loans-to-one borrower restrictions for the thrift industry as defined in the National Bank Act and required under FIRREA. Banks have operated successfully under these or similar restrictions for years. However, over the years banks also have developed extensive participation networks that effectively diversify the risk of one borrower to more than one institution. A properly structured loan participation allows selling banks to accommodate large loan requests which would otherwise exceed lending limits, while enabling them to diversify risk, and improve liquidity or obtain additional lendable funds. While we see no reason why thrifts cannot operate successfully under these restrictions, we recognize that full and immediate implementation of these restrictions places a legitimate short-term hardship on the industry. The building of such a loan-sharing network requires time to develop and mature if thrift institutions are to continue to service their largest borrowers. For this reason a transition rule is needed to phase in the restrictions.

The capital standards of FIRREA provide for a transition period in which qualifying supervisory goodwill may be included as a portion of a savings association's core capital requirement. Between now and December 31, 1991, supervisory goodwill is recognized up to one-half of core capital which must equal at least 3 percent of the association's total assets. The amount of supervisory goodwill allowed in the core capital calculation is phased out over the next three-year period and is eliminated on January 1, 1995. During this transition period, we would expect that lending limits would be based on eligible book capital rather than just tangible capital.

These lending limits apply to all types of credit extensions, not just acquisition, development and construction (ADC) loans. ADC loans are just one type of investment opportunity for a savings association. We encourage all financial institutions to develop a policy of risk diversification. This spreading of risk is particularly important in the thrift industry where capital levels are low and loan portfolio concentrations are high. Continuation of these concentrations only magnifies the exposure faced by the deposit insurer.

Q.10. Some critics suggest that the FDIC's proposed regulation on the use of purchased mortgage servicing rights to satisfy the tangible capital requirement "would render as many as 100 thrifts insolvent." American Banker, January 29, 1990, p. 11. I am interested in what the practical consequences of the proposal actually would be.

A.10. The American Banker quote is inaccurate. The regulation, as proposed, would limit the amount of purchased mortgage servicing rights that can be recognized for regulatory capital purposes to no more than 25 percent of core capital and 50 percent of tangible capital. However, for those institutions with purchased mortgage servicing rights in excess of these limits, a provision was incorporated into the proposal to allow the excess amount of these existing mortgage servicing rights to be phased out over a six-year transition period. Further, the first "haircut" on the servicing rights would not be imposed until eighteen months after the effective date of the regulation. Thus, no thrift institutions would be immediately "rendered insolvent" by this proposed FDIC rule. Rather, a gradual phase-out will occur over an extended time frame for any disallowed mortgage servicing rights and much of this reduction will result simply from the amortization of the existing book value of the servicing rights.

In addition, a mortgage banking subsidiary exception could also be used. That is, the limits on servicing rights in the proposed regulation would not apply if the mortgage servicing activity is conducted in a separately capitalized mortgage banking subsidiary and if any investments in and extensions of credit to the subsidiary are deducted in calculating the amount of the parent thrift's regulatory capital. In order to use this exception, extensions of credit and other transactions with the subsidiary would need to be conducted in compliance with sections 23A and 23B of the Federal Reserve Act, 12 U.S.C. 371c. Further, any contracts entered into by the subsidiary would need to include a written disclosure indicating that the subsidiary is not a bank or savings association, the subsidiary is an organization separate and apart from any bank or savings association, and the obligations of the subsidiary are not backed or guaranteed by any bank or savings association nor are they insured by the FDIC.

The intent of the proposed regulation is not to prevent thrifts from engaging in mortgage servicing activity, but rather to ensure that any excessive concentrations of investments in purchased mortgage servicing intangible assets are funded from outside sources rather than from insured deposits.

As to the practical consequences of the proposal, a complete assessment of that cannot be made until the FDIC has had an opportunity to review first quarter 1990 thrift activities on a consolidated basis. The filing of consolidated data -- which begins with the March 1990 report -- will capture the amount of purchased mortgage servicing rights held by mortgage banking subsidiaries of thrifts and, thus, will provide a more accurate figure of the amount of such rights held on a consolidated basis. A final decision on the proposed regulation will not be made until we have reviewed those numbers.

Q.10(a). Please list all SAIF-insured thrift institutions that have more than 1 percent of their total assets in purchased mortgage servicing rights, and provide the following information for each such institution:

(1) the institution's total assets;
(2) the dollar value of its purchased mortgage servicing rights (computed in accordance with FIRREA);
(3) the institution's return on average assets;
(4) its ratio of core capital to total assets;
(5) its ratio of tangible capital to total assets if purchased mortgage servicing rights were allowed to satisfy 100 percent of the tangible capital requirement; and
(6) its ratio of tangible capital to total assets under the FDIC's proposal.

A.10(a). Exhibit A, which is attached, provides estimates of the above information based on the year-end 1989 regulatory reports filed by thrifts with the Office of Thrift Supervision. Since the December 1989 thrift regulatory reports do not provide consolidated financial information, purchased servicing rights owned by subsidiaries of thrifts are not reflected. Thrifts will began filing on a consolidated basis with the March 1990 report, at which time a more accurate figure will be available as to the amount of servicing rights held by thrifts on a consolidated basis.

Nonetheless, based on the December 31, 1989 reports, 71 thrifts have a book value for purchased mortgage servicing rights that equals one percent or more of total assets. Exhibit A, under the column heading for "TangCap (FDIC Rule)," provides the estimated tangible capital ratios that would exist for these thrifts under the proposed FDIC regulation _if_ there were no transition period for phasing disallowed purchased servicing rights out of regulatory capital.

However, any disallowed mortgage servicing rights purchased on or before August 9, 1989 will be gradually phased out of regulatory capital over a six-year transition period and the first "haircut" will not be imposed until 18 months after the effective date of the final rule. This extended transition period, combined with the exception allowed for separately capitalized mortgage banking subsidiaries, is intended to significantly cushion the immediate impact on thrifts of the proposed rule.

Q.10(b). How many profitable institutions would meet the tangible capital requirement if purchased mortgage servicing rights were allowed to satisfy 100 percent of that requirement, but would fail that requirement under the FDIC's proposal?

A.10(b). If the proposed rule provided no transition period for phasing disallowed purchased servicing rights out of regulatory capital, Exhibit A indicates that 18 institutions that were profitable in 1989 and that met the existing 1.5 percent tangible capital requirement would fail to meet the tangible capital requirement under the FDIC proposal. Five of these institutions would still have a positive tangible capital ratio. Of the remaining 13 thrifts, each has an investment in purchased mortgage servicing rights that equals 4 percent or more of total assets and that exceeds 100 percent of tangible capital. However, in view of the transition period allowed in the FDIC proposed rule, these institutions would have an extended time frame for phasing out of capital any disallowed purchased mortgage servicing rights.

Q.10(c). Some critics argue that the FDIC's proposal would force those institutions to dump their current servicing rights at fire-sale prices. Do you agree?

A.10(c). No. The intent of the regulation is not to force institutions to sell their servicing rights. Rather, if an excessive concentration exists for purchased mortgage servicing rights in relation to capital, the intent of the regulation is to ensure that this excess amount is funded by owners' equity or other outside funding sources rather than by insured deposits. In view of the six-year phase-out period allowed in the proposed rule for grandfathered servicing rights, much of this reduction will automatically occur via the regular amortization of the book value for the servicing rights.

In addition, the amount of rights subject to the core capital and tangible capital limitations also can be reduced by placing the rights in a separately capitalized mortgage banking subsidiary or by increasing the amount of owners' equity. Obviously, the sale of the servicing rights is an option a thrift may also consider, but a thrift has several other alternatives under the proposed FDIC rule for dealing with excess amounts of purchased mortgage servicing rights.

Q.11. Opponents of the FDIC's proposed regulation suggest that the secondary market for mortgage servicing rights is so active and efficient that such rights are highly liquid and their value is readily ascertainable. Does the FDIC experience give you any cause for concern that purchased mortgage servicing rights held by failed thrifts could end up being illiquid, overvalued, or otherwise a source of loss?

A.11. No two servicing rights portfolios are the same. As a result, assumptions as to prepayment estimates, servicing costs, credit losses and foreclosure costs, will vary from portfolio to portfolio. In addition, even when the same portfolio is valued by different appraisers, significant variances may exist as to the estimated fair market value of the servicing rights in view of the myriad assumptions that are used in calculating the "present value" of the future net income stream to be derived from the servicing portfolio. These assumptions may or may not turn out to be accurate. Also, the determination of how much it will cost a thrift to service the mortgage loans may be subject to inaccurate or otherwise incomplete estimates. When such occurs, an institution effectively may significantly overpay for the servicing rights. Certain banks and thrifts have incurred significant losses as a result of their mortgage servicing operations.

Mortgage servicing rights can be sold. However, they are not traded on any organized exchange and are far from being a perfect "commodity." In addition, negotiations for the sale of a portfolio and the performance of a "due diligence" review by the purchaser may take several months. Also, it may be difficult to sell servicing rights without providing the buyer with a number of "warranties and representations" that effectively require the seller to retain a number of risks associated with the servicing portfolio. In view of these risks, as well as the other credit, prepayment/interest rate, operational and market risks that were described in detail in the preamble to the FDIC's proposal, the FDIC believes it prudent to place limits on the amount of these intangible assets that may be recognized for regulatory capital purposes.

EXHIBIT A

SAIF-INSURED THRIFTS WITH MORTGAGE SERVICING RIGHTS EQUAL TO ONE PERCENT OR MORE OF ASSETS

(Dollar Amounts in Thousands)

	Name	City & State		12-31-89 Total Assets	Purch MSRs	Return on Assets	Core Cap Ratio	Tang Cap Ratio	TangCap (FDIC Rule)	MSRs to TA
1	Central S&L	Jackson	MS	$ 48,014	$ 23,806	-13.16%	-52.1%	-53.2%	-102.8%	50%
2	Sterling SB	Southfld	MI	127,116	25,733	1.38	6.9	6.9	-13.4	20
3	Colo SrpgS&L	Col Sprg	CO	35,220	6,926	-1.74	6.6	6.4	-13.3	20
4	Meritbanc SA	Houston	TX	200,721	37,006	-36.62	-79.4	-80.9	-99.3	18
5	Cenlar FSB	Princeton	NJ	825,509	147,690	-0.60	1.6	0.1	-17.7	18
6	Standard FSB	[illegible]ithsbrg	MD	1,712,760	266,350	0.34	2.4	2.4	-13.1	16
7	Midfirst S&L	Okla City	OK	756,622	110,276	0.40	5.7	5.2	-9.4	15
8	Republic S&L	Loudon	TN	16,083	2,270	0.32	3.5	2.0	-12.1	14
9	MercantileSB	Southhavn	MS	53,839	7,246	0.37	3.3	2.3	-11.1	13
10	Universal SB	Milwaukee	WI	85,453	10,247	0.10	5.1	5.1	-6.9	12
11	Argo S&L	Summit	IL	42,586	3,973	1.00	5.0	3.5	-5.8	9
12	First Cty Bk	Hattsburg	MS	245,678	21,461	-3.95	-2.5	-3.3	-12.0	9
13	Southern FB	Gulfport	MS	147,907	12,822	0.11	1.5	1.5	-7.2	9
14	BannerbancSA	Garland	TX	54,206	4,202	-7.23	-18.8	-18.8	-26.6	8
15	AmerHome S&L	Edmond	OK	83,893	6,245	-4.17	-5.0	-5.0	-12.4	7
16	First Sec Sv	BlmfldHls	MI	91,036	6,590	1.68	5.0	5.0	-2.3	7
17	The Sav Bk	Arlington	TX	142,736	8,692	-1.59	0.1	-1.4	-7.5	6
18	Entrprise SB	Chicago	IL	531,174	29,384	-2.15	-7.3	-8.8	-14.4	6
19	Heartland FS	Ponca Cty	OK	925,387	50,715	1.66	2.0	2.0	-3.5	5
20	Guardian FSL	Bakersfld	CA	17,029	888	-84.26	-79.4	-79.4	-84.6	5
21	CharterBk	Santa Fe	NM	93,293	4,745	1.00	3.0	3.0	-2.0	5
22	Security SL	Jackson	MS	403,236	20,049	-1.67	1.9	0.4	-4.5	5
23	Inv of FlaSB	DrfldBch	FL	232,178	11,475	-2.59	0.4	0.4	-4.5	5
24	Colonial FS	Cape Gird	MO	177,421	7,384	-0.98	-7.1	-7.1	-11.3	4
25	Colonial SL	FortWorth	TX	562,578	22,833	1.04	8.3	8.3	5.7	4
26	Olympic SB	Seattle	WA	241,242	9,604	-0.65	2.3	2.2	-1.7	4
27	Fst NrthCoop	Keene	NH	115,669	4,519	0.26	4.0	3.2	-0.7	4
28	Republic SB	Jupiter	FL	128,122	4,988	0.43	3.7	3.7	-0.2	4
29	Houston SA	Houston	TX	68,233	2,549	0.32	5.6	5.6	2.5	4
30	Dep Tr SvBk	Monroe	LA	97,966	3,397	-6.70	-3.1	-3.1	-6.6	3
31	The Fed SvBk	Swnsboro	GA	187,079	6,385	0.07	1.0	0.7	-2.7	3
32	Provident FS	Casper	WY	244,946	8,294	-1.06	-1.3	-1.3	-4.7	3
33	Sterling SB	WPlmBeach	FL	80,374	2,552	0.05	4.2	4.2	1.4	3
34	Leader FB	Memphis	TN	2,138,618	67,175	0.12	4.1	3.3	0.3	3
35	Univ Fin Sv	Chicago	IL	265,474	7,321	-0.15	3.6	2.1	-0.6	3
36	Fidelity FSB	Corinth	MS	74,583	2,054	-39.46	-103.8	-103.8	-106.6	3
37	Essex Sv Bk	Eliz Cty	NC	302,452	8,184	0.38	3.1	3.1	0.5	3
38	CrownSvAssoc	Castlbry	FL	178,283	4,698	0.53	6.6	6.6	5.2	3
39	Key Sv Bk	Brandnton	FL	86,698	2,106	0.26	4.8	4.4	2.7	2
40	HomeOwnSvBk	Boston	MA	3,625,249	84,435	-0.80	-1.4	-2.9	-5.2	2

EXHIBIT A (continued)

SAIF-INSURED THRIFTS WITH MORTGAGE SERVICING RIGHTS EQUAL TO ONE PERCENT OR MORE OF ASSETS

(Dollar Amounts in Thousands)

	Name	City & State	12-31-89 Total Assets	Purch MSRs	Return on Assets	Core Cap Ratio	Tang Cap Ratio	TangCap (FDIC Rule)	MSRs to TA
41	Duval Fd SL	Jacksonvl FL	$1,027,373	$22,711	-1.45%	-3.8%	-5.3%	-7.6%	2%
42	First LA FSB	Lafayette IA	142,568	3,099	-3.55	-18.1	-18.1	-20.3	2
43	Fidelity SA	Wichita KS	529,140	11,481	0.70	4.2	4.2	2.7	2
44	Otero Sav	Colo Sprg CO	395,675	8,253	-20.81	-41.3	-41.3	-43.4	2
45	Plaza S&L	Santa Ana CA	67,951	1,380	3.06	8.4	8.3	8.4	2
46	NCB Sv Assoc	Hillsboro OH	26,686	505	0.52	19.8	18.3	18.3	2
47	UnitedCalSB	Anaheim CA	662,888	12,368	-0.57	4.6	4.6	3.6	2
48	GtyBk for Sv	Milwaukee WI	276,287	5,093	0.28	5.8	5.8	5.3	2
49	Asheville FS	Asheville NC	386,552	7,016	0.38	5.1	4.5	3.8	2
50	UnitedSvBk	San Fran CA	1,018,828	17,045	0.61	4.6	4.5	3.8	2
51	Carteret SB	Newark NJ	6,097,461	98,626	0.13	3.5	2.0	0.7	2
52	WesternFSL	MrnaDelRy CA	4,808,685	77,015	0.63	3.1	1.6	0.0	2
53	Altus Bank	Mobile AL	2,280,339	35,339	-0.78	1.6	0.1	-1.4	2
54	1stHomeFSL	Grnsboro NC	1,176,802	17,052	-0.18	3.3	1.8	0.8	1
55	First FSL	Lima OH	215,870	3,049	-0.24	3.7	3.5	2.9	1
56	WstrnEmpire	YorbaLnda CA	406,574	5,707	-2.98	-3.7	-5.2	-6.6	1
57	ColonialCSB	MtClemens MI	568,223	7,824	-0.24	3.8	3.6	3.0	1
58	SecFSL-Lake	East Chgo IN	172,843	2,322	0.68	6.4	6.4	6.7	1
59	Hamilton SB	San Fran CA	396,551	5,197	0.49	5.1	4.7	4.6	1
60	United SvBk	FarmHills MI	84,805	1,025	-0.40	3.8	3.8	3.5	1
61	WillmsbrgSB	SaltLkCty UT	310,520	3,675	-8.48	-5.4	-6.9	-8.1	1
62	Taylorbanc	Taylor TX	129,620	1,528	-7.06	-12.1	-12.1	-13.2	1
63	FirstAmSv	Tuscon AZ	163,368	1,881	-1.81	2.9	2.8	2.3	1
64	United FSL	RockyMt NC	343,759	3,924	-0.11	4.6	4.1	4.1	1
65	EastoverBk	Jackson MS	583,155	6,588	0.18	5.6	5.1	5.1	1
66	CtyFdSvBk	Elizabth NJ	8,582,471	96,095	-13.07	-9.4	-9.4	-10.5	1
67	SaratogaSL	San Jose CA	104,630	1,167	-1.42	4.6	4.6	4.6	1
68	Capitol FSL	Aurora CO	1,077,683	11,510	-9.32	-4.5	-4.6	-5.7	1
69	UnifirstBk	Jackson MS	635,812	6,700	-8.78	-19.5	-19.5	-20.5	1
70	Capitol FB	Chicago IL	43,144	444	8.32	7.9	6.4	6.4	1
71	CrestmontFS	Edison NJ	1,686,616	17,224	-0.87	3.7	3.7	3.6	1

OVERSIGHT BOARD
RESOLUTION TRUST CORPORATION
1825 Connecticut Avenue, N.W.
Washington, D.C. 20232

March 21, 1990

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Enclosed you will find responses from the Oversight Board to the questions submitted by Senator Garn following the January 31 hearing of the Committee on Banking, Housing, and Urban Affairs. These responses reflect the collective views of the Board members, each of whom received a request to answer these questions.

I hope the Committee finds this information responsive to its concerns.

Sincerely,

William Taylor
Acting President and
Chief Executive Officer

Enclosure

cc: The Honorable Jake Garn

Questions for Oversight Board Members from Senator Garn

Q. 1. Various reports indicate the interest in acquiring failed S&Ls is weak and may even be declining. Some of these reports attribute this lack of interest to the restrictions placed upon thrifts by the S&L bill and by regulations issued since its enactment. To what extent do you believe that higher capital requirements, the tightened QTL test, and limitations on loans to one borrower are driving away potential bidders for thrifts? To what extent does this increase the cost of the bailout? Do you believe that the regulators should have additional discretionary authority in establishing such restrictions?

A. 1. While no empirical study has been done to show the interest in acquiring failed thrifts is weak or declining, acquirer follow through for RTC-held thrifts has been somewhat less than expected. There are undoubtedly many reasons for this, including the fact that investor interest in the financial sector in general has not been robust.

Investor interest in thrifts also appears to have diminished relative to commercial banks. Capital requirements and lending limits have been tightened, essentially to mirror those of banks. But higher thrift insurance premiums and the qualified thrift lender test tend to make thrift investment less attractive.

There is no question that more restrictive thrift regulations have made it more difficult to attract potential bidders. The extent to which these limitations will increase the cost of resolving failed institutions cannot be measured at this time. Under any circumstances, one must also take into consideration the extent to which the pre-FIRREA regulatory environment contributed to the underlying losses which we are now trying to resolve.

Finally, you have asked whether regulators should be given additional discretionary authority. The law in many cases grants discretion, within the boundaries of safety and soundness. We find the caution reflected in FIRREA and that exercised by the regulators generally appropriate, if we are to prevent a reoccurrence of problems in the institutions which we are trying to cure.

Q. 2. In your view, would it be beneficial to draw capital into the thrift industry from outside sources, i.e. sources other than the banking or thrift industry? How much capital from these sources can realistically be expected? What changes, if any, in the bidding process would you suggest to increase the interest of nonbanking concerns to bid on thrift institutions?

A. 2. From an economic perspective, it is not clear that a meaningful distinction can be drawn between the banking and thrift industry and "outside" sources of capital. When a firm -- banking, thrift, or otherwise -- raises external capital to invest in a thrift, it routinely bids for funds in the public marketplace. Since a broad spectrum of investors participates in the market, "outside sources" of capital are in fact drawn into the thrift industry.

Perhaps more to the point, however, is the question of attracting bidders from outside the banking and thrift industry. Some have suggested that the lack of interest on the part of nonfinancial firms stems from the relative value of thrift and bank charters and the limitations on both bank and savings and loan holding companies.

If a potential acquirer considers a bank charter more attractive than a thrift charter, and therefore would want to convert, it faces the restrictions on ownership of nonbanking enterprises imposed by the Bank Holding Company Act. A diversified commercial company could own a thrift under the Savings and Loan Holding Company Act, but could face restrictions if that company sought to expand its holdings beyond one thrift, again in some circumstances reducing the incentive to enter the bidding process.

To the extent that nonbanking concerns have not exhibited interest in acquiring thrift institutions, we do not believe it to be a function of the bidding process. The RTC makes available to all interested parties its current list of conservatorship thrifts and advertises widely its offers to sell these thrifts.

Q. 3. The FIRRE Act requires the Federal Home Loan Banks to set aside substantial portions of their earning for use in an as-yet unstructured housing subsidy program. What is in place to ensure that these funds will actually go to help the poor to become homeowners?

A. 3. Staff of the Federal Housing Finance Board have worked closely with staff at HUD to develop an affordable housing program which will use Federal Home Loan Bank funds to meet national housing objectives. The interim regulations establishing this program, subject to notice and comment, were published in the Federal Register for public comment on March 2, 1990. The proposed program establishes guidelines that follow FIRREA's statutory mandates to ensure that the funds available under this program are used to benefit low-income homeowners and renters. Projects which do not benefit these individuals are not eligible for funding under the program. A copy of these regulations is attached.

Q. 4. Is it correct to assume that every dollar used in the housing subsidy program is an additional dollar that is lost to the RTC fund for resolutions? Does it really make sense to take money from the RTC that could be used to close down additional insolvent thrifts and use it instead for public housing purposes? If taking resources away from resolutions and putting it in housing subsidies allows an insolvent thrift to remain open, or at least to operate longer than it otherwise might, isn't that in the end costing the government more by raising the cost of the thrift resolution?

A. 4. The provision of subsidies in conjunction with the sale of RTC properties to low and moderate income purchasers may, where an active market for such properties otherwise exists, amount to an outlay of RTC funds which could be used for other purposes. However, there may be sensible economic reasons for the RTC to subsidize sales of eligible properties in addition to carrying out the affordable housing objectives of FIRREA.

In distressed real estate markets, price discounts or concessionary financing may speed up the sales of eligible properties by bringing new purchasers into the market. This in turn could substantially reduce the RTC's cost of holding properties and maximize the ultimate return to the government from the sale of assets.

In the enactment of FIRREA, Congress established five sometimes conflicting goals for the RTC, including maximizing the preservation of the availability and affordability of residential real property for low and moderate income individuals. The job of the Oversight Board is to see to it that the RTC conducts its operations in a manner that is consistent, to the maximum extent possible, with these five goals.

The Oversight Board has not and will not rule out the use of subsidy mechanisms authorized by Congress. They may prove to be a necessary tool in achieving FIRREA's affordable housing goal. We remain mindful, however, of the fact that the Congress has also instructed RTC to minimize losses, maximize returns, and make efficient use of funds.

Q. 5. The FIRREA Act and the Oversight Board's ethical standards are very demanding. Certain persons are barred completely from working for or contracting with the RTC due to past activities, while others are barred because of their business relationships. While I support high ethical standards for RTC employees and contractors, I wonder whether or not these standards have become counter-productive. As a practical matter, do the ethical standards hamper the RTC's ability to attract the best possible people for the job? Would you prefer to see the Oversight Board or the RTC given more discretion in establishing ethical standards for its employees and contractors, in light of the unusual nature of its mission?

A. 5. In compliance with FIRREA, the Oversight Board, acting together with the RTC, has prescribed regulations on minimum standards of competence, experience, integrity, and fitness applicable to persons providing services for the RTC. In prescribing such regulations, the Oversight Board and the RTC have followed FIRREA in prohibiting certain persons from being employed by or contracting to provide services for the RTC.

The provisions of the regulations concerning mandatory prohibitions are carefully limited, in accordance with statutory directions. Other provisions of the rule provide considerable discretion to the RTC in qualifying or disqualifying contractors and awarding contracts. Since the adoption of the rule, we have been informed by staff of the RTC that thousands of persons and firms have requested contractor registration packages and that hundreds of firms have been qualified by the RTC to be independent contractors.

At this time, in light of the information we are receiving from the RTC, we believe it would be premature to conclude that the adopted regulations hamper the RTC's ability to obtain the services of competent companies and individuals. The Oversight Board and the RTC will monitor implementation of the regulations to assure that the rule encourages private sector involvement in RTC's task, while not rewarding those who were responsible for the problem being addressed by the RTC.

From: Federal Register/Vol.55, No.42/Friday, March 2,1990/
pages 7479 to 7490.

FEDERAL HOUSING FINANCE BOARD
12 CFR PART 960
[No. FHFB 90-29]

AFFORDABLE HOUSING PROGRAM

AGENCY: Federal Housing Finance Board.

ACTION: Interim final rule; request for comments; Notice of open application periods and deadlines.

SUMMARY: The Federal Housing Finance Board ("Board") is adopting interim regulations for the operation of the Affordable Housing Program by the Federal Home Loan Banks ("Banks") in order to implement the provisions of Section 721 of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 ("FIRREA" Pub. L. No. 101-73, 103 Stat. 183, 423-426), which requires the establishment of an Affordable Housing Program ("Program" or "AHP"). The Program is designed to expand and strengthen the Banks' and their member institutions' support for affordable housing. The Program will help meet the most critical community investment and affordable housing needs.

DATES: Effective March 2, 1990.

Comments must be submitted on or before May 1, 1990.

Applications for Affordable Housing Program funds must be made between March 2, 1990 and May 1, 1990 for the initial 1990 AHP funding and between July 17, 1990 and August 31, 1990 for the final 1990 AHP funding.

ADDRESSES: Comments may be mailed to Federal Housing Finance Board, Secretariat, John Ghizzoni, 1777 F Street, N.W., Washington, D.C. 20006, where comments will be available for public inspection.

FOR FURTHER INFORMATION CONTACT: Richard Tucker, Deputy Director, Office of Housing Finance Programs, (202) 906-6211 or Stephen D. Johnson, Attorney Advisor, Office of Housing Finance Programs, (202) 906-6318, Federal Housing Finance Board, 1700 G Street, N.W., Washington, D.C. 20552.

SUPPLEMENTARY INFORMATION:

A. General

FIRREA added Section 10(j) to the Federal Home Loan Bank Act of 1932 ("FHLB Act" - 12 U.S.C. 1430(j)), which provides that, pursuant to regulations promulgated by the Board, each Bank must establish a Program to subsidize the interest rate on advances to members of the Federal Home Loan Bank System engaged in lending for long-term, very low-, low- and moderate-income, owner-occupied and affordable rental housing at subsidized interest rates. The Program that is established under FIRREA is designed to strengthen the Banks' and their member institutions' support for affordable housing.

The Board believes that the Banks and member institutions have an affirmative responsibility to provide financing that meets prudent, flexible, and innovative underwriting standards for very low-, low- and moderate-income housing for both owner occupants and tenants.

The Board has elected to operate the program as a series of twelve District-wide competitions. This reflects the statutory language that directs each Bank to establish a Program. The statute further specifies the dollar contribution of each Bank and establishes a procedure for the use of the remaining funds if any Bank fails to use the full amount of its statutory contributions.

However, while the Board has elected to operate the Program as a series of semiannual District-wide competitions, the regulations create an overarching uniformity by specifying a set of objectives and relative weights, the net result of which should be a consistent evaluation of projects and the attainment of national goals. The Board will monitor the consistency of project evaluation in two ways: (1) by evaluating the overall scoring across Districts when it reviews the projects submitted by the Banks and (2) by conducting post audits. While the Board believes it has given the Banks sufficient guidance on how to evaluate applications, it invites comments on any and all aspect of the evaluation process.

The Board anticipates that the Banks will fulfill their Program obligations primarily through the use of subsidized advances pursuant to the Federal Home Loan Bank System Credit Program ("Advances"). The Banks may also fulfill their obligations through the use of direct subsidies or other types of assistance to members.

In order to promote the use of the Program, the Banks are encouraged to explore all possible ways of reaching the targeted households and to encourage wide participation in the Program among their members. Furthermore, the Program is to be used in addition to the existing housing programs of the Banks, principally the Community Investment Program ("CIP").

As a means to foster broad-based support, the Board recognizes the value of encouraging the establishment of effective public/private partnerships and leveraging other sources of funds. The Board anticipates that funds provided under this Program may be used in conjunction with other sources of funds such as thw CIP, the low-income housing tax credit program, as well as other federal, state, or local and private assistance programs. The Board notes, however, while other sources of funding may be used in conjunction with the Program, the Board will consider the subsidies provided by these other funding sources in determining the maximum subsidy allowed under this Program.

The Board is aware of a variety of these programs that can be used to complement the Program and seeks to establish implementing regulations that will facilitate and maximize program integration. The Board encourages innovative efforts to provide subsidized credit for targeted households. Banks will provide technical assistance and guidance to their members on a wide range of possible initiatives and funding arrangements. Some examples of such arrangements are provided below.

1. Securitization - The securitization of loans made under the Program can broaden investor participation in very low-, low- and moderate-income housing finance. If successful, securitization can create a secondary market for these types of housing loans. There are a number of approaches available for accomplishing this securitization.

A member could borrow Program advances to fund eligible subsidized loans and swap the loans into mortgage-backed securities created by the Federal National Mortgage Association or the Federal Home Loan Mortgage Corporation. The Bank then could purchase the mortgage-backed security at par, allowing the member to use the sale proceeds to repay the Program advance. The difference between the par value of a security and its market value represents the Bank's subsidy.

Linking the Program with securitization and the secondary market offers a number of challenges. For example, successful packaging often requires credit enhancements to give the securities the necessary investment-grade rating. These enhancements include private mortgage insurance (either on individual loans or loan pools), the use of senior/subordinated structures, or recourse arrangements. Each of these enhancemqnts entails a cost and a risk for the provider of the enhancement.

The Board realizes that current secondary-market requirements and underwriting criteria may constrain the financing of affordable housing through securitization. The Board will work to assist in developing and institutionalizing creative solutions in such areas.

2. Consortia/Participations - Lender participation in the Program may involve a single project or groups of projects that involve several participating lenders. This involvement may take many forms including the development of lender consortia, jointly-owned service corporations, purchase of participation interests, or the purchase of mortgage-backed securities issued by special-purpose mortgage conduit corporations. Many of the successful public private partnerships in affordable housing already operate with multi-lender involvement.

3. Public Financing Sources - Public financing sources provide additional local, state, and federal funds. These range from the federal housing tax credit programs to the innovative use of local resources. A combination of these financing vehicles will assist in serving the Program's targeted households. These programs, most of which have already been used in conjunction with the CIP, provide excellent opportunities to reach even lower income households.

Low-income housing tax credits, authorized by the Tax Reform Act of 1986, are distributed through the states, often through state housing finance agencies. The program offers owner/investors a credit against federal income taxes based on the cost of acquiring, rehabilitating, or constructing low-income rental housing. The amount of tax credit received depends on the income level served.

Mortgage revenue bonds are issued by state and local housing finance agencies at below-market rates because the interest is tax exempt for federal-tax purposes. This interest savings is passed on to the homebuyer in the form of lower mortgage rates and is used as a means for financing moderate-income housing. The attractiveness of this source, however, has been significantly reduced by the Tax Reform Act of 1986.

Mortgage credit certificates (MCCs) authorize the borrower to take a direct tax credit every year against his/her federal tax liability until an equivalent of 20 percent of indebtedness is taken as a credit. All state housing finance agencies have the authority to establish these certificates on an optional basis. However, they count against a state's volume cap for mortgage-revenue bonds. Instead of using tax-exempt bonds to finance mortgage originations, state agencies can issue MCCs directly to the borrower mortgage is originated by the lender. This program is particularly useful for first-time homebuyer programs.

The Department of Housing and Urban Development ("HUD") offers several programs that may be used in conjunction with the Board's Program. These include:

> Community Development Block Grant Program - a multipurpose community program that places significant emphasis on activities that benefit low- and moderate-income households. Housing rehabilitation, public facilities, and economic development are a few of the areas emphasized by this program.
>
> Rental Rehabilitation Program - combines the resources of private investors, lending institutions, and the federal government to provide lower-cost rental units.
>
> Section 8 Housing Voucher Program - provides housing vouchers to low-income tenants to cover a portion of the rent for decent housing units of their choice. Section 8 has also been used with limited-equity cooperatives. This program can be quite effective when used in conjunction with low-income tax credits.

In addition to the HUD programs listed above, other government agencies such as the Farmers Home Administration, the Veterans Administration, and the Small Business Administration, offer programs that provide assistance to low- and moderate-income households and communities.

B. Analysis of the Regulation

1. Establishment of the Program - The board of directors of each Federal Home Loan Bank must adopt an implementing plan for the Program established by FIRREA and implemented in these regulations. The regulations require the Banks to submit their plan to the Board prior to the end of the application period.

2. Use of subsidized advances and direct subsidies - As required by the FIRREA, the regulations provide for the Banks to subsidize the interest rates on advances to members engaged in lending for long-term, low- and moderate-income, owner-occupied and rental housing. Additionally, since the Board believes the Banks should maximize the resources provided under the Program through the innovative use of Program subsidies, the regulations also permit the use of direct subsidies and other types of subsidized assistance.

The regulations define subsidy as the dollar amount of direct cash payments to the Program or the net present value of the foregone cash flows to the Bank resulting from making funds available under the Program at rates below the cost of funds. Defining the subsidy to equal the present value of future cash flows provides for an upfront funding of future obligations. The Board believes it is appropriate to adopt this funding approach to the Program; it is also in accord with generally accepted accounting principals. Upfront funding of the subsidy commitment ensures that adequate funding will be available in future years and allows for a steady stream of new projects each year to meet changing national and regional policy objectives.

While an alternative program that used annual funding of the subsidy commitment would allow an increased number of projects to be funded in the first year, such an approach could create substantial funding and administrative problems.

For example, given the expected volatility in annual contributions by the Banks to the Program, funding shortfalls could occur. Furthermore, although this approach would allow significantly more projects to be funded the first year, no new projects could be funded in subsequent years until the loans on the original projects were repaid.

The design of the Program is such that members are encouraged to participate in projects that they might not otherwise consider. For example, the subsidy could act, in some instances, as the mechanism that will allow the member to make a loan it might not otherwise have made, priced at a level consistent with the ultimate borrower's ability to pay, while still making an attractive spread.

The Board expects that, with the exception of pricing, the terms and conditions of the advances offered by the Banks to members as part of the Program will conform to the Banks' credit underwriting and collateralization standards. The Board also expects that the members, in making loans under the Program, will apply prudent underwriting standards. Members are required to maintain safe and sound lending practices consistent with the requirements of their primary regulator to ensure that Program loans are within acceptable risk levels.

As required by FIRREA, the regulations describe two broad purposes for Affordable Housing Program (AHP) subsidy use: (1) to finance the purchase, construction, and/or rehabilitation of owner-occupied housing for very low-, low- and moderate-income households; and (2) to finance the purchase, construction, and/or rehabilitation of rental housing, at least 20 percent of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of such housing or the mortgage term.

While the Board encourages financing arrangements that may be used for leveraging the funds to be allocated under the Program, it realizes that some of these innovative concepts and financing arrangements may not be familiar to some members. Because of the Board's concern for safety and soundness and prudent lending, institutions not familiar with these financing techniques are encouraged to consider participating with experienced lenders.

3. Application for Funding - AHP funds will be made available on either on an annual or a semiannual basis. In the case of semiannual offerings, the initial funding during the first half of the calendar year shall not exceed 60% of the AHP funds for the year; the balance of AHP funds would be available in the second and final offering during the second half of the calendar year. Each Bank is to notify its members of the amount of annual Program funds available for the District, whether funding will be on an annual or semiannual basis, and begin accepting applications for Program funds, by January 15 (and again on July 15 for semiannual offerings) of each year. The Board will also publish notice of each Bank's available AHP funds. The deadline for submitting applications to the Bank will be 45 days later. Those applications receiving the highest ratings will be forwarded by the Bank to the Board not later than 45 days after the close of the application period. The Board will announce final funding decisions within 30 days thereafter. For 1990, however, the application deadline for the first AHP funding is 60 days after publication of this rule in the Federal Register.

To ensure that Program subsidies are allocated for the priority uses intended and the specific households targeted, the regulations require that a member's application for a subsidized advance, direct subsidy, or other assistance include a description of the project and its conformity with Program objectives. The application must also include: a description of the feasibility of the project including local market conditions; the qualifications of the sponsor, if any; the calculation of the subsidy requested; and certifications that funding received will not be used for arbitrage purposes, that the project will not receive subsidy in excess of that allowed by the FHLB Act or the regulations and that the subsidy shall only be used for authorized purposes. The application must also include a description of the long-term monitoring techniques that will be used by the member to ensure the appropriate use of Program funds and the recapture of any unused subsidy.

4. Project Scoring and Funding - The Program will operate through a nationally administered series of District-wide competitions. There will not be special allocations for states or jurisdictions. Each Bank will evaluate applications on the basis of a number of criteria or objectives that are included in the regulation. These objectives reflect the broad goals of reaching the targeted households, providing maximum assistance per subsidy dollar, and encouraging innovation, community involvement, and community stability.

The regulations identify seven priorities for the Program subsidies:

(1) Projects that finance the purchase, construction, and/or rehabilitation of owner-occupied homes for very low-, low- and moderate-income households in that priority order; or

(2) Projects that finance the purchase, construction, and/or rehabilitation of rental housing, at least 20 percent of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of such housing or the mortgage term; or

(3) Projects that finance the purchase and/or rehabilitation of housing owned or held by the United States Government or any agency or instrumentality of the United States including those held by the U.S. Department of Housing and Urban Development, the Resolution Trust Corporation, Farmers Home Administration, Veterans Administration, Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation; or

(4) Projects that finance the purchase, construction, and/or rehabilitation of housing, which is sponsored by any nonprofit organization, any state or political subdivision of any state, any local housing authority, or state housing agency; or

(5) Projects that empower the poor through resident management, urban homesteading and similar programs; or

(6) Projects that promote fair housing; or

(7) Projects that provide permanent housing for the homeless.

Each Bank will first separate the submitted projects into two groups: (1) those that meet at least three of the priorities identified in the regulation and (2) those that meet fewer than three of the priorities. Projects in the first group will be rated before projects in the second group. Second group projects will only be rated and forwarded to the Board if there are insufficient applications in the first group. The Banks should consider, however, projects not forwarded to the Board for assistance under other programs as as the Community Investment Program (CIP).

To ensure that the projects funded conform to Program objectives, the Banks will evaluate all projects using the 100 point scoring system described in the regulation. The Banks will rank order the applications within each of the groups identified above based on the sum of the point totals for the applications.

The scoring system divides the Program objectives into three groups. The total possible score a project may receive is 100 points. The first, and most important objective is the consistency of the project with the priorities identified in the regulation. Projects may receive up to 25 points for this objective, with a project's actual point total reflecting its consistency with, or potential for achievement of, the priorities.

The second group of objectives includes: (1) targeting - the extent to which the project targets households below the statutory maximum, especially very-low income households; (2) long-term retention - the potential for long-term retention of owner-occupied and rental housing affordable for very low-, low- and moderate-income households; and (3) effectiveness - the effective use of Program dollars, i.e., the number of units to be built or mortgages to be granted per AHP subsidy dollar, including the extent to which the project is able to draw upon other sources of funds and programs designed to benefit targeted households. The Bank may award each project up to 15 points per objective in this group.

The third group of objectives includes: (1) community involvement - the extent to which the project involves non-profit or community organizations; (2) community stability - the extent to which the project maximizes community stability and minimizes the displacement of very low-, low- and moderate-income households; and (3) innovation - the use of innovative and experimental non-financial and financial approaches toward providing affordable housing for very-low, and low- and moderate-income households. The Bank may award a project up to 10 points for each objective in this group.

After the Bank has evaluated applications from members, the Bank will forward to the Board for final funding consideration those projects receiving the highest overall rankings. To ensure an adequate pool of projects for Board consideration, the regulations require each Bank to forward to the Board applications from the highest ranking projects sufficient to exhaust the funds available to the Bank under the Program plus the next four highest-ranking projects. The regulations provide, however, that if in the Board's opinion there is an insufficient number of applications from any Bank, the Board may request that the Bank submit additional eligible applications.

The regulations also require the Bank to submit a summary of each project to the Board. The summary shall include a brief description of the project, the amount of subsidy requested, a description of how the member and Bank will monitor the project, a description of the provisions for recapture of the subsidy, and the reason for the points awarded for each of the enumerated objectives.

The Board will review the projects submitted by each Bank to ensure national consistency with the Program's stated goals, priorities, and objectives. Based on this review and the rankings submitted by the Banks, the Board will make final funding decisions.

5. **Reporting** - To facilitate reporting, the Board is designing and will implement at the outset of the Program a comprehensive computerized AHP reporting system. The AHP application will be entered into the system upon receipt by the Bank. The entry will be updated to include the disposition of the application and the progress of the project if the application is approved and funded.

Members that receive subsidies will be required to file periodic reports with the Bank until the subsidy has been fully used or repaid. The reports will, at a minimum, describe the manner in which the member has used the proceeds of the subsidy and contain a certification that the subsidy continues to be used for the proposed purposes.

6. **Monitoring** - A variety of safeguards have been built into the Program to monitor project performance and ensure adherence to Program guidelines and regulations. These monitoring elements are designed to prevent Program misuse and ineffective use of Program assets.

Monitoring by the member and its board of directors is required. The member must include in each AHP application an explanation of how the member intends to monitor and report the use of any subsidy or other assistance provided by the Bank including copies of any agreements entered into for this purpose. Each Bank must monitor, audit, and review its Program and member Program projects to ensure full compliance.

At a minimum, the Board and the Banks will audit the following Program elements: Bank contributions, subsidy calculations, pricing, development, promotion, marketing, and compliance. In addition, member project development, subsidy delivery, loan pricing (including mark-up, fees, and, terms), community involvement, oversight, and innovative approaches to financing affordable housing will also be monitored. The Board has the responsibility and authority to monitor, audit, and review Bank and member compliance using all resources at its disposal.

Techniques for monitoring may include audits of applications and supporting documentation, loan-record analysis, specialized reporting and data gathering, and site inspections. The application process, periodic reporting, data gathering and site visits by Bank personnel will help provide necessary information.

Monitoring AHP advances and assistance for single-family homeownership will in all instances require compliance with a one-time initial income eligibility requirement to ensure that only the targeted households are the recipients of the subsidies. In certain cases, such as community land trusts and limited-equity housing cooperatives, where long-term retention of income eligibility requirements and use restrictions are present, longer-term monitoring will be necessary, particularly at the time of sale or transfer of the housing unit.

Monitoring multifamily rental projects will require long-term tracking (both of use and income levels) to ensure that Program subsidy benefits remain available to very low-, low- and moderate-income households. Most local, state, and federally funded housing programs are targeted to very low-, low- and moderate-income households, and income eligibility is set and maintained for a designated period. Where Program subsidies are used in tandem with such programs, the income level recertification process required by the other program (usually annual) will normally satisfy the income eligibility monitoring requirements of the Program. Where other local, state, and federal officials perform field visits, loan and lease reviews, and other inspections, additional information will be available to assist the Board and the Banks in monitoring efforts.

7. **Recapture** - If at any time the proceeds of a subsidized advance will not be or cease to be used for authorized uses and eligible projects, the member who received such an advance must immediately notify the Bank that granted the advance. The member should immediately cease to provide subsidized funds to the project. Upon receipt of such notice, the Bank shall recover the unused or improperly used portion of the subsidized advance, and, in doing so may exercise a number of options, including: repricing the advance to the interest rate applicable at the time the advance was made on non-subsidized advances of comparable type and maturity; requiring the member to reimburse the Bank for the amount of the subsidy remaining on the advance; assessing a prepayment penalty; or calling such advance. Under all circumstances, any subsidy committed but no longer used for an eligible project will become available for future projects.

To prevent potential windfall profits through the premature sale of rental housing that has been subsidized using AHP funds, members must either provide the Banks with evidence that the sales contract includes a provision that the housing will continue to be used for its original purpose, or agree to reimburse the Bank an amount equal to the pro rata subsidy value considered to have been realized by the seller as profit, based upon the amount of the subsidy and the remaining term of the project as originally proposed.

8. **Maximum Subsidy** - The Board believes it is important that recipients of Program subsidies contribute towards the provision of their housing. As such, the regulations set the maximum subsidized assistance to the amount needed to reduce the monthly housing payment for the targeted household to 28 percent of gross monthly income.

If the subsidized assistance is in the form of an advance, the regulation also specifies that the loan to the borrower shall be subsidized at least to the same extent as the advance is subsidized; the borrower must receive the full benefit of the subsidy.

9. Contributions to Program - The regulations set forth the funding requirements for the Program. As provided in FIRREA, the Banks are required to contribute a percentage of their preceding year's net income to the Program. Beginning in 1990, this amount shall be five percent of the preceding year's net income increasing to six percent in 1994, and to 10 percent in years thereafter.

The regulation also sets forth minimum annual total amounts that must be contributed by the Bank System as a whole as required in FIRREA. From 1990 through 1993, at least $50 million must be contributed annually to the Program by the Banks. This amount will increase to $75 million in 1994, and to $100 million annually thereafter. To the extent that the percentage of income-based annual contributions of the Banks do not meet these minimal, additional contributions shall be made *pro rata* by each Bank based on net income such that the minimum dollar requirement shall be met. Each Bank's *pro rata* share of such additional contribution will be determined by dividing the Bank's net income for the relevant period by the total System net income for the same period and then multiplying the percentage derived by the amount of the System shortfall.

The regulations clarify the method of calculation of net income for purposes of determining contributions. Section 721 of FIRREA defined net earnings as follows:

> The net earnings of any Federal Home Loan Bank shall be determined for purposes of this paragraph -
>
> > (A) after reduction for any payment required under Section 21 or 21B of this Act; and
> >
> > (B) before declaring any dividend under Section 16.
>
> 103 Stat. 424.

The Board believes it is appropriate to distinguish between those contributions made out of current income and those covered by historical retained earnings. The regulations, therefore, provide that, for purposes of calculating the annual amount of contributions, the Banks' annual net income is reduced by the $300 million from current year earnings made under Section 21 and 21B of the FHLB Act.

10. Temporary Suspension of Contributions - Consistent with Section 721 of FIRREA, the Board is providing a procedure for the temporary suspension of contributions in extraordinary circumstances. If a Bank believes that a temporary suspension is appropriate, the Bank must immediately notify the Board and make written application. The application should be accompanied by it

preceding year's annual report and the most recent quarterly and monthly financial statements. Banks that apply for temporary suspension may also submit additional information not provided for in these regulations to support its case for suspension.

The regulations specify factors the Board will consider in determining whether to approve an application for temporary suspension, including, any decline in the Bank's quarterly or annual net income, paid-in membership capital, level of advances, and projections for these trends to continue. The Board will also consider other financial conditions that may contribute to the Bank's financial instability and financial data the Bank submits in support of its application.

The Board will disapprove a temporary suspension application if the Bank's financial instability results from a change in the term of advances, other than subsidized advances, inordinate operating and administrative expenses, non-standard banking practices, mismanagement, or is not justified by market conditions.

The Board will act on written applications for temporary suspension within 30 days of receipt, but the temporary suspension shall not take effect until the time period expires for a joint resolution of Congress disapproving the temporary suspension. The Board decisions shall be accompanied by specific findings and reasons for the action. All temporary suspensions will be granted for a specified time period. The Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate and each Bank shall receive written notice of any temporary suspension.

During a temporary suspension, the Bank shall provide the Board any financial reports the Board may require. The Board may determine at any time during the suspension that the Bank has returned to a position of financial stability and the Board may terminate the temporary suspension upon written notice to the Bank. A Bank may apply in writing for an extension of a temporary suspension, and the Board shall act on the request within 20 days of receipt. The Board will determine the effective date, issue written notice, and notify Congress and the Banks of extensions in a fashion similar to original temporary suspensions.

Congressional notice of suspensions will be sent to the Committees 60 days prior to the effective date of a suspension and 30 days prior to the effective date of an extension. The temporary suspensions granted by the Board will become effective on their prescribed dates, unless a joint resolution of Congress disapproving the temporary suspension is enacted prior to the effective date.

11. Unused Contributions - If a Bank fails to use the amount it is required to contribute to the Program in a given year, 90 percent of the unused amount will be paid over to the Affordable

Housing Reserve Fund at the end of the year. The 10 percent of the unused or uncommitted amount retained by the Bank should be fully utilized or committed by that Bank during the following year and any remaining portion must be deposited in the Program Reserve Fund.

12. Reserve Fund - The regulations provide for a reserve fund, to be used in the event that a Bank does not use all of its Program funds in a given year. Unused Program funds from one year will go into this reserve fund to be administered by the Board. Any Bank may apply to the Board to use the reserve funds, but only after its current annual allocation to the Program has been committed.

13. Coordination - The regulations require the Board and the Banks to coordinate Program activities to the maximum extent possible with other government agencies and with the appropriate non-profit organizations.

14. Advisory Councils - FIRREA requires the establishment of Program Advisory Councils by each Bank pursuant to regulations promulgated by the Board, as follows:

> (11) ADVISORY COUNCIL. -Each Bank shall appoint an Advisory Council of 7 to 15 persons drawn from community and non-profit organizations actively involved in providing or promoting low- and moderate-income housing in its District. The Advisory Council shall meet with representatives of the board of directors of the Bank quarterly to advise the Bank on low- and moderate-income housing programs and needs in the District and on the utilization of advances for these purposes. Each Advisory Council established under this paragraph shall submit to the Board at least annually its analysis of the low-income housing activity of the Bank by which it is appointed.
>
> 101 Stat. 425-426.

In recognition of the economic and geographic differences among the Bank Districts, the Board provides in these regulations that each Bank has the discretion to determine the size and member composition of its Advisory Council. Each Bank shall give consideration to the size and diversity of its District and the very-low, and low- and moderate-income housing needs of its District. The regulations provide that the composition of each Bank's Advisory Council must reflect the very low-, low- and moderate-income housing activities and needs within the District, as well as the full range of the community and non-profit organizations' concerns.

FIRREA provides flexibility in the selection of Council members in each District. At the same time, experience and commitment to providing and/or promoting very low-, low- and moderate-income housing should be the most important factors in choosing members. The Board recognizes that state and local housing agencies represent a significant resource, based on their extensive experience in this area, that may be included in the Advisory Councils; however, in an effort to encourage broad representation, state and local agency officials should not constitute an undue proportion of the Council membership.

The nomination and selection process in the regulations is aimed at encouraging broad local participation in the process. Each Bank should actively solicit nominations from as many community and non-profit organizations as can be identified. In order to defray the expense of participating in the Advisory Councils, members will be compensated by the Banks for travel expenses and paid a subsistence allowance.

The regulations require that Council members serve staggered two-year terms. In so directing, the Board seeks to provide continuity in experience and service to the Advisory Council, as well as to provide frequent opportunities for new groups and individuals to serve on the Councils. Banks may use one-year terms initially, provided that all Banks must include in their Advisory Council plan a provision for staggered terms beginning no later than January 1991 that will ultimately lead to two-year terms with one-half of the terms expiring each year.

Each Council will designate one of its members or a member of the Bank's staff to act as Secretary of the Advisory Council. The Secretary will record and maintain minutes of the meetings of the Council. Minutes of each meeting shall contain, among other things, a record of the persons present, a description of the matters discussed, and recommendations made. The Secretary's reports will be the initial basis for the annual Council reports to each Bank and the Board.

The regulations require that each Bank submit annually to the Board, for review and approval, a detailed plan for the operation of its Advisory Council.

During the review and approval process, the Board will discuss with the Banks any suggested additions and changes in order to ensure consistency among the Banks' Advisory Council structures, while leaving appropriate flexibility and discretion in each District.

C. Notice of 1990 AHP Funding and Open Application Period

For calendar year 1990, the Banks will have AHP funds available as follows:

BANK	DISTRICT	1990 AHP ($ millions)
FHLB of Boston	CN, MN, MA, NH, RI, VT	5.982
FHLB of New York	NJ, NY, PR, VI	7.443
FHLB of Pittsburgh	DE, PA, WV	3.692
FHLB of Atlanta	AL, DC, NC, SC, FL, GA, MD, VA	8.643
FHLB of Cincinnati	KY, OH, TN	2.352
FHLB of Indianapolis	IN, MI	3.577
FHLB of Chicago	IL, WI	2.437
FHLB of Des Moines	IA, MN, MO, ND, SD	2.729
FHLB of Dallas	AR, LA, MS, NM, TX	12.782
FHLB of Topeka	CO, KS, NE, OK	4.908
FHLB of San Francisco	AZ, NV, CA	20.172
FHLB of Seattle	AK, GU, HI, ID, MT, OR, UT, WY, WA	4.066
TOTAL		78.783

See the "Dates" section above for the open application periods and the final deadlines for 1990 applications.

Applications will only be accepted from members of the Federal Home Loan Bank System; the Federal Home Loan Banks do not make direct loans to borrowers.

D. Request For Public Comment

The Board requests public comments and suggestions on a wide range of affordable housing and community-oriented lending issues. Broad public participation will assist the Board in: (1) preparing the final regulations for the Program; (2) designing other proposed regulations for community-oriented lending programs; and (3) developing programs to finance affordable housing in our nation's communities and neighborhoods. The list of issues and questions below is not exclusive; comments are requested on any issues and policy questions related to the operation and structure of the Program.

The Board specifically seeks comments on:

- whether additional objectives should be included in the scoring system and whether the relative weights assigned to the various objectives are appropriate.
- the 28 percent of income criterion for calculating the maximum subsidy.
- whether the regulation should also set a maximum basis point limitation or alternative limitations on the subsidies
- how the Program and community-oriented lending initiatives can be best coordinated.
- reports the Board should require of Banks and members to facilitate analysis and oversight.
- monitoring issues.
- offering the Program more than twice a year. Given the variance in the funds available by district, how the money should be allocated among offerings.

The Board also seeks comment on the general areas of:

- How can the Board and the Banks ensure that the Program reaches those that need it most?
- What are the best techniques to leverage Program subsidies?
- What local, state, and federal housing programs are best suited to be used in tandem with the Program?
- What new and innovative programs for affordable housing development and ownership should the Board consider?
- Are there projects or lending techniques that the Program should avoid or prohibit?
- How should the Board and the Banks preserve the long-term affordability of housing subsidized by the Program?
- What steps should be taken to foster neighborhood stability and manageable growth?

Administrative Procedure Act

The Board is adopting this regulation as an interim final rule effective on publication in the Federal Register without the usual notice-and-comment period or delayed effective date provided for in the Administrative Procedure Act, 5 U.S.C. 553. Those requirements may be waived for "good cause." 5 U.S.C. 553(b)(3)(B), 553(d)(3). A nationwide crisis in housing currently exists, to which Congress has responded by mandating this Program, to ensure decent, affordable housing and a suitable living environment to the large numbers of families and individuals. The Board finds that good cause exists because of the necessity of beginning the Program following its establishment by the enactment of FIRREA, wherein the Program definitions, funding, priorities, and restrictions are all expressly stated. In FIRREA, Congress specifically charged the Federal Home Loan Banks to "help the most critical community investment and affordable housing needs through utilization of special cash advance programs." H.R. Conf. Rep. No. 222, 101st Cong., 1st Sess. 429 (1989). Providing notice and comment procedures and a delayed effective date would be impractical and contrary to the public interest because the Board could not immediately discharge its statutory responsibilities. The Board also notes that 1990 Program funds will not be exhausted prior to the receipt and analysis of public comment.

Regulatory Flexibility Act
Because no notice of proposed rulemaking is required for these regulations, the provisions of the Regulatory Flexibility Act (5 U.S.C. 601, et seq.) do not apply.

List of Subjects in 12 CFR Part 960:

Credit, Federal home loan bank, Housing, Reporting and recordkeeping requirements

Accordingly, the Board hereby amends Chapter IX, Title 12, Code of Federal Regulations, by adding a new Subchapter E, consisting of Part 960, as set forth below.

Subchapter E - Affordable Housing

Part 960 - Affordable Housing Program

Section

960.1 Definitions.
960.2 Establishment of program.
960.3 Use of subsidized advances and direct subsidies.
960.4 Applications for funding.
960.5 Project scoring and funding.
960.6 Reporting requirements.
960.7 Monitoring.
960.8 Recapture.
960.9 Maximum subsidy.

960.10 Annual contributions.
960.11 Temporary suspension of contributions.
960.12 Unused contributions.
960.13 Affordable Housing Reserve Fund.
950.14 Coordination.
960.15 Advisory Councils.

Authority: Sec. 1, 47 Stat. 725, as amended (12 U.S.C. 1421 et seq.); sec. 10, 47 Stat. 731, as amended (12 U.S.C. 1430); sec. 21B, as added by sec. 511, 103 Stat. 394 (12 U.S.C. 1441b).

§ 960.1 Definitions.

(a) Advances means extensions of credit to members under the Federal Home Loan Bank System Credit Program subject to this part 960 and 12 CFR part 935.

(b) Affordable for very-low income households means that monthly housing expense charged to tenants for units made available for occupancy by very-low income households shall not exceed 30 percent of the adjusted gross income of a very low-income household.

(c) Area means a metropolitan statistical area, a county, or a nonmetropolitan area, as established by the Office of Management and Budget.

(d) Community or non-profit organizations means private, not-for-profit community-based organizations committed to serving community housing and development needs of very low-, low- and moderate-income households.

(e) Cost of funds means the estimated cost of raising Bank consolidated obligations as published from time to time by the Federal Home Loan Bank System's Office of Finance, with maturities comparable to those of the subsidized advances.

(f) Low- and moderate-income households means any household for which the aggregate income is eighty percent (80%) or less of the area median income.

(g) Median income means the median income for an area as determined and published by the United States Department of Housing and Urban Development.

(h) Member means an institution admitted to membership in a Federal Home Loan Bank ("Bank").

(i) Net earnings of a Bank means the net earnings of a Bank for a calendar year after deducting the Bank's pro rata share of the $300 million annual contribution to REFCORP.

(j) Program means the Affordable Housing Program established by this part.

(k) Subsidy means the direct cash payment to the Program or the net present-value of the foregone cash flows to the Bank from making funds available under the Program at rates below the cost of funds.

(l) Very low-income households means households for which the aggregate income is fifty percent (50%) or less of the area median income.

§ 960.2 Establishment of program.

(a) It is the policy of the Board and the Banks to promote decent and safe affordable housing and to address critical affordable housing needs through the use of subsidized advances, direct subsidies, and other assistance to members.

(b) Each Bank's board of directors should adopt an implementation plan consistent with FIRREA and these regulations to provide subsidized advances, direct subsidies, or other assistance to members engaged in long-term lending that provides owner-occupied and rental housing affordable to very low-, low- and moderate-income households. A copy of the plan shall be submitted to the Board prior to the end of the application period defined in section 960.4 of this part.

§ 960.3 Use of subsidized advances and direct subsidies.

(a) General. (1) Funds under each Bank's Program shall be used to provide subsidized assistance to members engaged in lending for activities eligible to receive subsidized assistance pursuant to the provisions of Section 10(j) of the Act and this part. Subsidized advances made under the Program shall be consistent with the provisions of the Act and the regulations applicable to advances in general contained in 12 CFR part 935 except to the extent modified by this part. Direct subsidies and other assistance provided to members shall comply with the provisions of this part.

(2) In making extensions of credit under the Program, members shall use prudent, flexible, and innovative underwriting standards. Members shall maintain safe and sound lending practices consistent with the requirements of their primary regulator, designed to return a profit, but will be encouraged and assisted in funding qualified projects that do not meet customary or existing secondary mortgage market requirements or for which no secondary market exists. The Board and the Banks shall encourage and assist the development of new secondary markets for projects funded by the Program.

(b) Authorized uses. All members receiving subsidized advances, direct subsidies, and other assistance from a Bank shall use the proceeds of such subsidies and the benefits of such assistance to:

(1) Finance the purchase, construction, and/or rehabilitatio of owner-occupied housing for very low-, low- and moderate-income households; or

(2) Finance the purchase, construction, and/or rehabilitatio of rental housing, at least twenty percent (20%) of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of such housing or the mortgage term.

(c) Each Bank shall ensure that the preponderance of subsidies provided by the Bank is ultimately received by very low-, low- and moderate-income households in its District.

§ 960.4 Applications for funding

(a) The Program is based on annual or semiannual District-wide competitions administered by the Board. In case of semiannual offerings, the initial Program funding during the first half of the calendar year, shall not exceed 60 percent of the Program funds for the year; the balance of the Progra funds shall be offered and available during the second half of the calendar year. Each Bank shall notify its members of the amount of the annual Program funds available for the District, whether funding will be on an annual or semiannual basis, and begin accepting applications for Program funds by January 15 (and again by July 15 for semiannual offerings) o each year. The Board will also publish a list of each Bank' available funds under the program. The deadline for submitting applications to the Bank will be 45 days later. Those applications receiving the highest ratings will be forwarded by the Bank to the Board not later than 45 days after the close of the application period. The Board will announce the final funding decision within 30 days thereafter. For 1990, the application deadline is 60 days after publication of this rule in the Federal Register. The amount of funding for each District will be based on the amount contributed by each Bank in accordance with Section 960.10 of this part.

(b) Each member shall include in its application for a subsidize advance, direct subsidy, or other assistance:

(1) A concise description of the purpose for the request, it relationship to the Program's priorities identified in Section 960.5(b), and its consistency with the criteria identified in Sections 960.5(c), 960.5(d) and 960.5(e);

(2) A description of the feasibility of the project, including the local market conditions justifying the project;

(3) The qualifications of the sponsor;

(4) The calculation for the subsidy requested;

(5) An explanation of how the member intends to monitor and report the use of any subsidy or other assistance provided by the Bank including an explanation of how the structure of the project ensures that a preponderance of the assistance is ultimately received by the targeted groups;

(6) A certification that the subsidy received by the project will not exceed the maximum allowable under this program and an explanation of how any excess subsidy will be recaptured; and,

(7) A certification that the subsidy or other assistance shall only be for authorized uses.

§ 960.5 Project scoring and funding.

(a) General. (1) Each Bank will evaluate by the due date all applications received from its members that satisfy the use provisions identified in section 960.3(b). Projects should first be evaluated regarding their feasibility including the ability of the member to qualify for an advance to fund the project.

(2) Feasible projects that meet at least three of the priorities identified in paragraph (b) of this section shall be grouped and rated before projects that meet fewer than three of the priorities. Each Bank will then rank the projects within the first group (i.e., those meeting at least three priorities) based on the criteria contained in paragraphs (c), (d), and (e) of this section. Projects in the second group will be rated if there are insufficient applications in the first group.

(3) The total possible score a project may receive is 100 points. The maximum numerical score that a Bank may assign any project meeting the criterion identified in paragraph (c) of this section is 25 points, in paragraph (d) of this section is 15 points per criterion, and in paragraph (e) of this section is 10 points per criterion. In determining the number of points to award a project for any given criterion, the Bank should evaluate each proposed project relative to the other proposals received by the Bank, with the project best achieving the criterion receiving the highest point score for that criterion and the remaining projects scored on a declining scale.

(b) Priorities. Projects meeting at least three of the following objectives shall have priority for funding:

(1) Projects that finance the purchase, construction, and/or rehabilitation of owner-occupied homes for very low-, low- and moderate-income households in that priority order; or

(2) Projects that finance the purchase, construction, and/or rehabilitation of rental housing, at least twenty percent (20%) of the units of which will be occupied by and affordable for very low-income households for the remaining useful life of such housing or the mortgage term; or

(3) Projects that finance the purchase and/or rehabilitation of housing owned or held by the United States Government or any agency or instrumentality of the United States including those held by the U.S. Department of Housing Urban Development, the Resolution Trust Corporation, Farmers Home Administration, Veterans Administration, Federal National Mortgage Association, and the Federal Home Loan Mortgage Corporation; or

(4) Projects that finance the purchase, construction, and/or rehabilitation of housing, which is sponsored by any nonprofit organisation, any state or political subdivision of any state, any local housing authority, or state housing agency; or

(5) Projects that empower the poor through resident management, urban homesteading and similar programs;

(6) Projects that promote fair housing; or

(7) Projects that provide permanent housing for the homeless.

(c) 25 Point Category

Consistency with Priorities. To ensure consistency with the priorities identified in paragraph (b) of this section 960.5, projects that achieve the greatest number of priorities or achieve more than one goal in a superior manner shall be awarded the most points in this category.

(d) 15 Point Category.

(1) Targeting. To encourage the flow of Program resources to households with incomes below the statutory maximums, the Bank will consider the extent to which the project targets households below the statutory maximums. The most points should go to projects serving the greatest number of very-low income households.

(2) Long-term Retention. To promote the continued availability of housing affordable for very low-, low-

and moderate-income households, the Bank will consider the extent to which the project facilitates the maximum retention of such housing as evidenced through the existence of long-term guarantees, covenants, and similar techniques. The Bank will evaluate the type of assurances and the number of units and years for which these assurances are given.

(3) Effectiveness. To ensure that the Program resources help the greatest number of households, the Bank will consider how effectively the project uses the Program subsidy dollars. Within this context, effectiveness should be measured by the number of units to be built or rehabilitated, or mortgages to be granted per Program subsidy dollar. A higher ratio reflects a more effective use of the subsidy dollars. To the extent a project is able to attract and efficiently use other sources of funds, (i.e., leverage the Program dollars) this will be reflected in the effectiveness ratio.

(e) 10 Point Category.

(1) Community Involvement. To be successful, most projects will need the support of the community in which the project is being proposed. Therefore, to encourage and facilitate the involvement of community interest groups in addressing the housing needs of the targeted groups, the Bank will consider the extent to which a project involves non-profit and community organizations, other than as sponsors, the breadth of community interests represented by the groups, and the extent to which the group is local in nature. More points should be given to projects that involve local groups representing a broad range of community interests.

(2) Community Stability. While the Program is designed to promote affordable housing, it should not do so at the expense of the households in the community being served. Therefore, the Bank shall evaluate the extent to which a project preserves community stability by minimizing the displacement of very low-, low- and moderate-income households and the extent to which the project serves existing very-low, and low- and moderate income members of the community.

(3) Innovation. To encourage innovation in providing affordable housing for very low-, low- and moderate income households, the Bank will consider the extent to which the project involves a particularly new or unusual approach for meeting the housing needs of these groups. In assessing a project under this criterion, the Bank will consider the degree to which the sponsor demonstrates that the project uses an innovative approach that holds promise of successfully meeting the housing

needs of these groups. The Bank should consider both nonfinancial and financial innovation in providing affordable housing.

(f) (1) After the Bank has evaluated applications from members pursuant to this Section, the Bank shall forward to the Board for final funding consideration applications from those projects receiving the highest overall rankings. To ensure an adequate pool of projects for Board consideration, each Bank shall forward to the Board the highest ranking projects sufficient to exhaust the funds available to the Bank under the Program plus the next four highest-ranking projects. If in the Board's opinion there is an insufficient number of applications from any Bank, the Board may request that the Bank submit to the Board for review additional eligible applications.

(2) The Bank shall also submit a summary of each project forwarded to the Board. The summary shall:
(i) Briefly describe the project;
(ii) Indicate the amount of subsidy requested;
(iii) Describe how the member and Bank will monitor the project;
(iv) Describe the provisions for recapture of the subsidy, if necessary; and
(v) State the reason for the points awarded for each of the enumerated objectives.

(3) The Board will review the applications submitted from each Bank to ensure consistency with the Program's stated goals, priorities, and objectives. Based on this review and the rankings submitted by the Banks, the Board will make a final funding decision.

§ 960.6 Reporting requirements.

(a) Each Bank shall provide reports and documentation concerning the Program as the Board may from time to time request.

(b) To meet Board requests for reports and documentation, each Bank shall require members that receive a subsidy to file periodic reports with such Bank continuing until the subsidy has been fully used or repaid by the member. Reports shall, at a minimum, state the manner in which the member has used the proceeds of the subsidy and shall include a certification that the subsidy has been passed through by the member to the borrower. Reports shall be supported by appropriate underlying documentation.

(c) Each Bank will require the boards of directors of members receiving subsidies to report to the Bank on their use at least annually and to certify that the subsidy has been passed through to the borrower. Reports shall be supported by underlying documentation.

(d) Each Advisory Council established under this Part shall submit to the Board by January 31, 1991, and each subsequent year its analysis of the low-income housing activity of the Bank by which it is appointed.

§ 960.7 Monitoring.

(a) The Board shall have the responsibility and authority to monitor, audit, and review Bank and member compliance with the Program requirements of the Act, this Part, and other applicable laws and regulations. The Board shall, in its discretion, use all necessary resources, including Office of Inspector General and Office of General Counsel personnel, Program support staff, and specialized contractors.

(b) Each Bank shall monitor, audit, and review its Program and member Program projects and lending to guarantee full compliance.

(c) The Board and the Banks, at a minimum, shall audit the following Program elements:

(1) Bank contributions, subsidy calculations, pricing, development, promotion, marketing, and compliance.

(2) Member project development, subsidy delivery, loan pricing (including mark-up, fees, and terms), community involvement, oversight, and innovative approaches to financing affordable housing.

(d) Monitoring of Program performance and compliance shall be by audits of applications and supporting documentation, loan-record analysis, specialized reporting, data gathering, site inspections, and such other techniques determined by the Board as necessary to detect and eliminate violations, fraud, mismanagement, and dissipation of Program assets.

(e) Miscalculations, errors, and violations of Program guidelines identified by the Board or a Bank shall be corrected immediately. In cases where subsidies have been improperly received, the Bank shall recover the subsidy amount, with penalties and interest if appropriate, in accordance with section 960.8 of this part. Other violations of the Act, this Part, or other laws and regulations shall be referred to the Board, the Bank, and other agencies of competent jurisdiction for criminal prosecution or civil recovery.

§ 960.8 Recapture.

(a) A member shall notify the Bank immediately upon receiving information that the proceeds of a subsidized advance or other subsidized assistance granted by the Bank to the member will not be or are no longer being used for the purposes approved by the Bank and the Board. The member shall not advance any further subsidized funds. Furthermore, the amount of committed but unused subsidy or improperly used subsidy shall be recovered and made available by the Bank for future projects.

(b) In recapturing unused or improperly used subsidies, the Bank shall, at its discretion, take any or all of the following actions:

(1) Reprice the advance at the interest rate charged to members on non-subsidized advances of comparable type and maturity at the time of the original advance;

(2) Call the advance;

(3) Assess a prepayment penalty;

(4) Require the member to reimburse the Bank for the amount of the subsidy remaining on the advance or other assistance.

(c) To preclude potential windfall profits on the premature sale of rental housing where a Program subsidy has already been fully used to develop or rehabilitate the property, the member shall agree, in the event of such a sale, to:

(1) Provide the Bank with evidence that the sales contract includes a provision that the rental housing will continue to be used for the purpose originally intended; or

(2) Agree to reimburse the Bank an amount equal to the pro rata subsidy value considered to have been realized by the seller as profit, based upon the amount of the subsidy and the remaining term of the project as originally proposed.

§ 960.9 Maximum subsidy.

(a) A Bank shall not offer subsidized advances and other subsidized assistance to members in excess of that amount needed to reduce the monthly housing cost for the targeted household to 28 percent of the household's gross monthly income.

(b) A member receiving a subsidized advance shall extend credit to qualified borrowers at an effective rate of interest discounted at least to the same extent as the subsidy granted to the member by the Bank.

§ 960.10 Annual contributions.

(a) Each Bank shall fund its Program in accordance with the following formula:

(1) On January 1 of 1990, 1991, 1992, and 1993, the greater of:

(i) 5 percent of the Bank's net income for the previous year (as defined in Section 960.1 (i) of this Part); or

(ii) That Bank's pro rata share of an aggregate of $50 million to be contributed in total by the Banks. Such proration shall be made on the basis of the net income of the Banks for the previous year.

(2) On January 1 of 1994, the greater of:

(i) 6 percent of the Bank's net income for the previous year; or

(ii) That Bank's pro rata share of an aggregate of $75 million to be contributed in total by the Banks, such proration being made on the basis of the net income of the Banks for the previous year.

(3) On July 1 of 1995 and each year thereafter, the greater of:

(i) 10 percent of the Bank's net income for the previous year; or

(ii) That Bank's pro rata share of an aggregate of $100 million to be contributed in total by the Banks such proration being made on the basis of the net income of the Banks for the previous year.

(b) Funding sources for subsidized advances and subsidies under the Program shall be at the discretion of each Bank.

§ 960.11 Temporary suspension of contributions.

(a) If making the contributions required by § 960.10 of this Part will lead to the financial instability of a Bank, the Bank shall notify the Board as soon as it learns of the problem. The Bank may apply for a temporary suspension of Program contributions. The application for the temporary suspension shall be in writing and shall be accompanied by the Bank's preceding year's annual report, if available, and the Bank's most recent quarterly and monthly financial statements. In addition, the application shall state the period of time for which the Bank seeks a suspension and shall include a plan for returning the Bank to a financially stable position.

(b) In reviewing a Bank application for temporary suspension of contributions, the Board shall consider the following factors and financial data:

(1) The extent to which the Bank's quarterly or annual net income has decreased from the preceding quarter or year and whether such decline is projected to continue;

(2) The extent to which the Bank's paid-in membership capital has declined in any given quarter or year and whether such decline is projected to continue;

(3) The extent to which the Bank's level of advances has declined in any given quarter or year and whether such decline is projected to continue;

(4) Other financial conditions, which, in the opinion of the Bank's board of directors, have resulted, or are likely to result in the financial instability of the Bank; and

(5) The financial data submitted by the Bank in support of its application.

(c) The Board shall disapprove an application for a temporary suspension if it determines that a Bank's financial instability is a result of:

(1) A change in the terms of advances (other than subsidized advances) not justified by market conditions;

(2) Inordinate operating and administrative expenses ;

(3) Operation of the Bank in a manner contrary to accepted banking practices for the Banks;

(4) Mismanagement; or

(5) If for any other reason the temporary suspension is not warranted.

(d) Within thirty (30) days after receipt of a written application made pursuant to paragraph (a) of this Section, the Board shall approve or disapprove such application in writing. The Board's decision shall be accompanied by specific findings and reasons for its action and shall state the time period for any temporary suspension. A copy of the decision shall be forwarded to the Congress as provided in paragraph (g) of this Section and a copy forwarded to each Bank.

(e) During the term of a temporary suspension approved by the Board, the affected Bank shall provide to the Board such financial reports as the Board shall require to monitor the financial condition of such Bank. If, in the opinion of the Board, a Bank has returned to a position of financial stability prior to the conclusion of the temporary suspension period, the Board may, upon written notice to the Bank, terminate such temporary suspension.

(f) A Bank may apply for an extension of a temporary suspension when such Bank's board of directors determines that the Bank has not, or is not likely to, return to a position of financial stability at the conclusion of the temporary suspension. A request for an extension is to be in written form and shall be approved or disapproved by the Board within twenty (20) days of receipt. The Board's decision to approve or disapprove a request for an extension shall be accompanied by specific findings and reasons for its actions and shall state the effective date and time period of any extension. A copy of such decision shall be forwarded to the Congress as provided in paragraph (g) of this Section and a copy forwarded to each Bank.

(g) The Board shall notify the Committee on Banking, Finance and Urban Affairs of the House of Representatives and the Committee on Banking, Housing and Urban Affairs of the Senate of any temporary suspension and any extension of a temporary suspension. A temporary suspension may not take effect until at least sixty (60) days after the Board gives the notice of its action required by this section. An extension of a temporary suspension may not take effect until at least thirty (30) days after the Board gives the notice of its action required by this section. Such suspension or extension shall become effective as determined by the Board unless a joint resolution of Congress is enacted, prior to the Board's determined effective date, disapproving such suspension.

§ 960.12 Unused contributions.

If a Bank fails to use or commit the amount it is required to contribute to the Program pursuant to § 960.11 of this Part in a given year, ninety percent (90%) of the amount that has not been used or committed in that year shall be paid over to the Affordable Housing Reserve Fund established and controlled by the Board. The ten (10) percent of the unused and uncommitted amount retained by a Bank should be fully utilized or committed by that Bank during the following year and any remaining portion must be deposited in the Affordable Housing Reserve Fund.

§ 960.13 Affordable Housing Reserve Fund.

(a) No later than January 15 of each year, each Bank shall provide to the Board, a statement indicating the amount of funds from the prior year, if any, which will be paid over to the Affordable Housing Reserve Fund.

(b) No later than January 31 each year, the Board will notify the Banks of the total amount available in the Affordable Housing Reserve Fund.

(c) Upon receipt of an application from a member, a Bank may apply to the Board for use of the available Reserve Funds. Such application shall only be made after the Bank has used or committed all of its current annual allocation to the Program. Such application shall state the amount of funds desired, the purpose of the advance to be made with such funds, and the subsidy to be made on the advance or other subsidized assistance. The application shall be accompanied by the written application of the member requesting a subsidy and shall be acted upon by the Board.

§ 960.14 Coordination.

The Board and the Banks shall coordinate activities under this Part, to the maximum extent possible, with other federal, state, or local agencies and non-profit organizations involved in affordable housing activities.

§ 960.15 Advisory Councils.

(a) Each Bank shall appoint an Advisory Council of 7 to 15 persons drawn from community and non-profit organizations actively involved in providing or promoting low- and moderate-income housing in its District. The Advisory Council shall meet with representatives of the board of directors of the Bank quarterly to advise the Bank on very low-, low- and moderate-income housing programs and needs in the District and on the use of subsidized advances, direct subsidies, and other assistance for these purposes. Each Advisory Council established under this Section 960.15 shall submit to its Bank and the Board at least annually its analysis of the low-income housing activity of the Bank by which it is appointed.

(b) Advisory Councils shall be appointed by the Banks giving consideration to the size and diversity of the District, and the very low-, low- and moderate-housing needs of the District.

(c) The composition of the Advisory Council shall reflect the very low-, low- and moderate-income housing activities and needs within the District, as well as the full range of community and non-profit organizations' concerns. Local and state housing officials may serve as members of an Advisory Council, provided that such officials do not constitute an undue proportion of the membership.

(d) The nomination and selection process shall be as broad and as participatory as possible. Each Bank shall actively solicit nominations from community and non-profit organizations, allowing sufficient lead time for responses.

(e) Council members shall be paid travel expenses by the Banks, including transportation and subsistence, for each day devoted to attending meetings.

(f) Council members shall serve terms of 2 years, but the terms shall be staggered to provide continuity in experience and service to the Advisory Council. Banks may use one-year appointments in establishing new Councils, provided that all Banks include in the Advisory Council plans submitted pursuant to paragraph (i) of this Section provisions for staggered terms beginning no later than January 1991 with one-half of the terms expiring each year.

(g) Each Council shall designate a member or request that a member of the Bank's staff be designated to act as Secretary of the Advisory Council. The Secretary shall record and maintain minutes of the meetings of the Council. Minutes of each meeting shall contain, among other things, a record of the persons present, a description of the matters discussed, and recommendations made. The person acting as Secretary at a meeting shall certify to the accuracy of the minutes of that meeting.

(h) Meetings of the Advisory Council shall be held at least once each quarter and may be held more frequently at the call of the Bank.

(i) By January 31, of each year each Bank shall submit to the Board for review a detailed plan for the operation of its Advisory Council during the year. Such plan shall be subjec to review by the Board. Plans shall contain such informatic as the Board may from time to time require and shall be updated by each Bank as necessary.

By the Federal Housing Finance Board.

Jack Kemp

Jack Kemp
Chairman

Date: 2/26/90

OVERSIGHT BOARD
RESOLUTION TRUST CORPORATION
1825 Connecticut Avenue, N.W.
Washington, D.C. 20232

March 21, 1990

The Honorable Donald W. Riegle
Chairman
Committee on Banking, Housing, and
Urban Affairs
United States Senate
Washington, DC 20510

Dear Mr. Chairman:

Enclosed you will find responses to the questions for Deputy Secretary Robson submitted by Senator Heinz following the January 31 hearing of the Committee on Banking, Housing, and Urban Affairs.

I hope the Committee finds this information responsive to its concerns.

Sincerely,

William Taylor
Acting President and
Chief Executive Officer

Enclosure

cc: The Honorable Jake Garn
The Honorable John Heinz

Questions for John Robson from Senator Heinz

Q. 1. The RTC Oversight Board approved a priority system for resolving insolvent thrifts with an emphasis on dealing first with those institutions that have the highest rate of deterioration. It would appear that those institutions that have deteriorated the most are likely candidates for deposit transfer or liquidations since there is little or no franchise value to these institutions. Consequently, it seemed that those institutions could be resolved quickly. During the hearing, I asked you how many of the approximately 300 insolvent institutions in the RTC are candidates for deposit transfer or liquidation. Since you did not know the answer, you indicated that the Oversight Board would supply that information for the record.

A. 1. The RTC cash flow model, which the Oversight Board staff has reviewed, projects resolution types based on institution characteristics. The projections are based on the 293 existing conservatorships and 40 RTC resolutions as of January 16, 1990.

The RTC cash flow model assigns one of three resolution methods based on asset quality and core deposit base: liquidation, clean-bank deals, and whole-bank deals. By far the largest percentages -- both in number of institutions and asset values -- fall into the clean-bank category. To be more specific, the model produces the following results:

- It assigns about a third of the institutions to the liquidation category. These institutions account for only about 10 percent of the gross book value of assets and liabilities.
- It assumes clean-bank resolutions for over half of the institutions, with almost 90 percent of the gross book value of assets and liabilities.
- The rest -- about one eighth of the institutions with only about two percent of assets and liabilities -- fall into the whole-bank category.

Having provided this answer, we would respectfully disagree with the assertion made during the hearing, that the Oversight Board cannot do its job without knowing these numbers. The cash flow model is not a plan. Rather, it represents a best guess about how things will turn out based on a series of assumptions, which in turn are based on imperfect information. If reality diverges from these assumptions, as it surely will in some cases, the results could turn out differently.

We believe the answer which Mr. Kearney gave was the right one. In the end, the market will determine, through the bidding process, which institutions should be liquidated.

Q. 2. During the hearing I raised concerns that the slow pace of resolutions suggested that the thrift industry was unable to draw outside capital because potential investors may have concluded that economic returns on investments in thrifts were not attractive in relation to other potential investments. I suggested that constraints on thrift activities that are not necessary to protect the federal deposit insurance system could hurt homebuyers and taxpayers alike. If thrifts are not economically viable, they will no longer serve as a provider of residential home finance. similarly, unnecessary restraints on thrift activities lower the value of a thrift charter, deter investor interest in purchasing thrifts and thereby increase the cost of resolutions to the taxpayers.

a. What is the Oversight Board's assessment of the value of a thrift charter?

b. How does the value of a thrift charter compare with the charters of other financial institutions?

c. Based on the bids received thus far, does it appear that the thrift industry can attract outside capital?

d. Are there ways to enhance the value of a thrift charter that are consistent with the necessity of protecting the federal deposit insurance system?

e. What effect does the Qualified Thrift Lender Test have on the value of a thrift charter?

f. What effect would a less stringent QTL test have on the safety of the federal deposit insurance system?

A. 2. It is clear that the value of a thrift charter has declined since the enactment of FIRREA. Despite what many people seem to think, however, it is not clear that a thrift charter has less value than that of a bank. Each has advantages over the other and relative values would seem to depend on who is making the assessment.

On one hand, thrifts are presently encumbered by higher insurance premiums and their asset powers are limited by the qualified thrift lender (QTL) test. But thrifts also retain advantages relative to banks: more favorable tax treatment; greater ability to expand geographically; a fewer restrictions on ownership.

We concur with the conclusion of a recent Office of Thrift Supervision (OTS) report[1], which finds that the economic value of a thrift charter cannot be precisely determined. Rather, it depends on the relative balance of factors such as those cited above as well as the objectives of the acquiring institution.

On the question of attracting outside capital, we would differentiate between outside capital and bidders from outside the banking and thrift industry. When an acquirer raises external capital to invest in a thrift, it routinely bids for funds in the public marketplace. By definition, this ensures that outside capital will be drawn into the thrift industry.

As for attracting bidders from outside the banking and thrift industry, it is probably too early to answer that question. Certainly there are disincentives, perhaps most notably the restrictions imposed by both the Bank Holding Company Act and the Savings and Loan Company Act.

If enhancing the value of a thrift charter means relaxing restrictions -- including the QTL test -- this will likely increase the exposure of the deposit insurance funds. In the face of a taxpayer-funded, multi-billion dollar cleanup program for the savings and loan industry, we believe that such changes would be ill-advised.

It would seem particularly shortsighted to weaken the regulatory structure in order to make the RTC's job easier. It may be expedient in the short run, but the result could be simply to prolong RTC's job, by importing problems back into its caseload.

Finally, on the question of the QTL test, it seems indisputable that this limitation has reduced the value of a thrift charter. Having said that, we would emphasize that reduced value does not in any way suggest lack of profitability. Indeed, information from OTS indicates that most thrifts which pass the QTL test have positive net income and meet capital requirements.

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[1] "The Value of a Thrift Charter: A Comparison of Bank and Thrift Powers," Office of the Chief Economist, Office of Thrift Supervision, February 1990.

Q. 3. During Senate consideration of the Financial Institutions Reform Recovery and Enforcement Act, I introduced, with the support of the FDIC, a number of measures designed to help the RTC and FDIC recover funds for the taxpayer from those who were responsible for losses at insolvent savings and loans. Those measures included providing the FDIC and RTC with a priority over shareholders in pursuing claims against officers, directors and others who caused losses at these institutions. The Senate supported these measures contained in section 214 of S. 774. However, they were opposed by the House conferees and not made part of the final bill enacted into law.

a. What are your views on the merits of providing a priority to the RTC to get funds back for the taxpayer?

b. What efforts have been taken to pursue claims against those who were responsible for losses at failed savings and loans?

c. What, if any, projections have been made concerning the number and dollar amount of potential claims to recover losses at failed savings and loans?

d. Should Congress reconsider giving the RTC a priority of claims in light of the potential reductions in the costs of thrift resolutions?

A. 3. The Oversight Board regards the pursuit by the RTC of claims against persons responsible for losses at failed thrifts as being especially important to the reestablishment of confidence in a responsible thrift industry. The RTC has established an Office of Investigations to identify these persons and to seek restitution on behalf of the taxpayer. That office expects its corps of investigators to reach 300 by year-end, and intends to make every effort to assist the Department of Justice in prosecutions.

In the FIRREA, Congress authorized the Justice Department to allocate additional funds and personnel to fraud cases involving financial institutions. Those resources will be necessary to address the more than 1200 referrals already sent to the Justice Department with respect to alleged criminal activity at RTC-controlled thrifts, as well as the many more referrals to be expected as a result of continuing and new investigations.

The RTC has recently estimated that about 60 percent of the thrifts in its caseload have been victimized by serious criminal activity. It is currently surveying regional and field sites to determine the exact number and nature of criminal referrals already made or expected to be made in the near future. The results of this survey are anticipated by the RTC to be available in mid-March.

In many thrift cases, the improper conduct of directors, officers, affiliates and other insiders gives rise to civil claims for recovery rather than criminal claims. The RTC is moving aggressively to pursue claims against these persons, as well as professional liability claims against accountants, appraisers and lawyers. Because these claims are asserted by the RTC as receiver on behalf of the failed thrift, it is difficult to estimate the amounts ultimately to be recovered by the RTC until all competing claims by other creditors are also determined. This uncertainty is compounded when the defendant is a third party such as an appraiser or an accountant who may, like many in distressed areas, be subject to a suit by competing creditors alleging claims arising out of unrelated transactions.

Section 214 of S. 774 contained a number of proposals to clarify or modify the existing authority of the FDIC and the RTC to pursue civil claims against such persons. Among these provisions was a proposal to grant the FDIC and the RTC a priority with respect to certain claims acquired by receiverships or conservatorships. Under sub-clause (o)(1) of section 214, any such RTC claim against an insolvent thrift's "director, officer, employee, agent, attorney, accountant, appraiser, or any other party employed by or providing services" to that thrift would have priority over claims asserted by depositors, creditors or shareholders of the insolvent thrift. Proposed section 214, accordingly, would have granted the RTC a priority claim over all other potential claimants, not merely over shareholders.

Granting the RTC this priority claim raises questions of both effectiveness and fairness. For example, should an insolvent thrift's stockholders, by bringing a fraud claim against the same thrift officer or accountant as the RTC, be entitled to share with the RTC the sums recovered on the claims? Should the RTC be entitled to a claim against the officer or accountant that is given priority over fraud claims by depositors and creditors? Should the insolvency rules for bankrupt thrifts in this area be different from the insolvency rules for bankrupt commercial entities? The Oversight Board believes that, as the pursuit of these claims moves past the investigatory stage into litigation and settlement, the collections experience of the RTC will have a direct bearing on whether Congress should grant to the RTC a priority claim over claims brought by depositors, creditors and shareholders, as was proposed in S. 774.

RTC
Resolution Trust Corporation

April 13, 1990

Dear Mr. Chairman:

Thank you for your letter forwarding Senator Garn's written questions in connection with the hearing held on January 31 before your Committee.

We are pleased to enclose responses to the questions for inclusion in the record of the hearing.

We hope this information is useful. Please let me know if we can be of further assistance.

With best wishes.

Sincerely,

L. Wm Seidman

L. William Seidman
Chairman

Honorable Donald W. Riegle, Jr.
Chairman
Committee on Banking, Housing,
and Urban Affairs
United States Senate
Washington, D.C. 20510

Enclosure

550 17th Street, NW ▪ Washington, DC 20429

RTC RESPONSES TO QUESTIONS FROM SENATOR GARN IN CONNECTION WITH THE JANUARY 31, 1990, HEARING BEFORE THE SENATE BANKING COMMITTEE

Q.1. Various reports indicate the interest in acquiring failed S&Ls is weak and may even be declining. Some of these reports attribute this lack of interest to the restrictions placed upon thrifts by the S&L bill and by regulations issued since its enactment. To what extent do you believe that higher capital requirements, the tightened QTL test, and limitations on loans to one borrower are driving away potential bidders for thrifts? To what extent does this increase the cost of the bailout? Do you believe that the regulators should have additional discretionary authority in establishing such restrictions?

A.1. Higher capital requirements and the tightened QTL test both have the effect of limiting the pool of potential bidders for troubled thrifts, although it is difficult to tell what effect this has on the cost of the bailout. We doubt that the loan-to-one-borrower limitation is having an impact on the number of bidders for troubled thrift institutions.

The less capital a bidder has to invest to purchase a troubled thrift, the less money the bidder has at risk, and the higher the expected rate of return on the investment. Thus, the higher the capital requirements, the lower the rate of return on an investment, and the fewer the number of bidders. However, capital is the insurance fund's primary cushion against failure. As the thrift crisis demonstrates, institutions with little capital often have an incentive to invest in very risky projects, since any loss is shifted from the institution to the insurance fund and ultimately the taxpayer. Thus, while higher capital requirements limit the number of potential bidders, and raise the amount of required assistance for returns to be competitive with other investments, they also serve to limit future failures. We do not believe that the minimum capital requirements established by FIRREA are unduly high, and we believe that the protection they afford to help ward off future failures outweighs the short run costs they may impose on the S&L bailout.

FIRREA imposed a tightened QTL test that will require savings associations to carry at least 70 percent of their portfolio in qualified real estate related investments by July 1, 1993. While we recognize the intent of the test, we believe that there is legitimate concern that complying with the new QTL standards will cause interest rate risk in the thrift industry, which is already high, to become even worse. Fear that the QTL test will cause a further deterioration of the thrift franchise value is probably having an adverse effect on the number of potential bidders for troubled thrifts. In our view, the full impact of the QTL test should be carefully reviewed to ensure that it does not have the unintended effect of decreasing the stability and profitability of the thrift industry.

Finally, FIRREA imposed a loan-to-one-borrower limitation on thrift institutions similar to that applied to national banks. Risk diversification is a fundamental principal of sound banking and we fully support FIRREA's application of loan-to-one-borrower limits to the thrift industry. We do not believe that these limits are driving away potential bidders for troubled thrifts.

We do recognize, however, that full immediate implementation of these restrictions may place a short-term hardship on the thrift industry. Over the years, banks have developed extensive participation networks that effectively diversify risk of one borrower to more than one institution. The building of such a loan sharing network requires time to develop and mature if thrift institutions are to continue to service their largest customers. For this reason, we would welcome regulatory discretion to set a transition rule to phase in the restriction.

Q.2. In your view, would it be beneficial to draw capital into the thrift industry from outside sources, i.e. sources other than the banking or thrift industry? How much capital from these sources can realistically be expected? What changes, if any, in the bidding process would you suggest to increase the interest of nonbanking concerns to bid on thrift institutions?

A.2. It would, of course, be beneficial to draw new capital into the thrift industry, but such capital must be attracted based on the basic economics of the industry.

We have proposed one fairly fundamental change to our bidding process that we believe may make institutions more attractive to outside investors, which is our accelerated resolutions program ("ARP"). Under ARP, institutions will be resolved before they are put under RTC conservatorship. This will prevent the wasting of franchise value under conservatorship as key personnel and customers desert an institution. This in turn should help make institutions more attractive to non-depository institution buyers that lack the infrastructure to purchase institutions that are no longer going concerns.

It should be recognized, however, that there are a number of structural factors that are not directly related to the bidding process that make non-depository institutions less likely acquirers of troubled thrifts than depository institutions. In particular, the purchaser of a troubled thrift needs to have capital and management immediately available. In addition, non-depository institution bidders are not able to recognize the economies of scale that can often be recognized by depository institution acquirers, especially in in-market acquisitions. These structural factors will not be affected by changes in the bidding process.

We do not know the amount of capital that can reasonably be expected from non-depository institution sources. We do know that a number of funds that were set up to purchase thrifts with RTC assistance have had difficulty raising capital. We also know that to date, there has been little investor interest by other than depository institutions.

Q.3. Is it correct to assume that every dollar used in the housing subsidy program is an additional dollar that is lost to the RTC fund for resolutions? Does it really make sense to take money from the RTC that could be used to close down additional insolvent thrifts and use it instead for public housing purposes? If taking resources away form resolutions and putting it in housing subsidies allows an insolvent thrift to remain open, or at least to operate longer than it otherwise might, isn't that in the end costing the government more by raising the cost of the thrift resolution?

A.3. To the extent that single family and multifamily properties are marketed and sell at fair market value, there is no direct subsidy resulting from the 90 day right of first refusal period. For multifamily properties, there may be missed revenue which would result from the increased speculative value associated with sales offers from private investors looking to take advantage of changing market conditions and future rent increases from properties to be marketed by the RTC. Access to information about the availability of affordable properties and the right of first refusal will offer a unique opportunity to qualified buyers without creating a cost to the RTC.

If subsidies, discount prices, and concessionary financing are necessary to ensure that qualified buyers purchase single family property or to provide for long term affordability by low-income renters then there may be a cost associated with the affordable housing provisions. The Oversight Board has encouraged the RTC to proceed with a demonstration program so that we can determine whether subsidies, discounts, or concessionary financing are needed and how we can structure financing that meets the needs of qualified buyers and is consistent with secondary mortgage market underwriting criteria.

With respect to discount prices during the demonstration program, there is an understanding that because of declining market value many of the properties the RTC will be selling are within the range of affordability for families at 80 percent of area median income and below. The Low-Income Housing staff has placed considerable emphasis on identifying an array of resources that can be marshalled in support of financing the sale of properties to low- and moderate-income homebuyers, an area which will be critical to the ability of low-income families to be able to purchase a home. That focus gave consideration to the specific provisions contained in the legislation creating the Affordable Housing and Community Reinvestment Program, to be administered by the Federal Housing Finance Board, and added provisions of the Community Reinvestment Act. It was viewed that Congress intended that these provisions will expand the range of affordability for purchasers who are to take advantage of our marketing efforts.

During this interim phase, the RTC will be selling property at market value consistent with guidelines issued governing the sale of the RTC's other real estate properties outside distressed areas. The RTC will encourage cash sales financed by private lenders and state and local housing finance agencies. To the extent verifiable holding costs are avoided, the RTC will pass those savings on to the purchaser.

As we begin the pilot demonstration, we want to understand what resources are available from private lenders, HUD, and the low-income housing programs of the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation. Upon completion of the demonstration program, we will look closely to determine what gaps in financing still remain for review with the Oversight Board prior to developing specific RTC programs. Based on the results of the demonstration, the RTC will have more experience in order to determine whether to provide price discounts and seller financing and how to do so. A primary focus of Low-Income Housing Staff in each region will be to identify a range of resources that can be utilized to finance sales including HUD mortgage insurance programs, Farmers Home, VA, Urban Homesteading, Fannie Mae, Freddie Mac and the Community Investment and Affordable Housing Programs to be created by the Federal Housing Finance Board.

Q.4. The FIRREA Act and the Oversight Board's ethical standards are very demanding. Certain persons are barred completely from working for or contracting with the RTC due to past activities, while others are barred because of their business relationships. While I support high ethical standards for RTC employees and contractors, I wonder whether or not these standards have become counter-productive. As a practical matter, do the ethical standards hamper the RTC's ability to attract the best possible people for the job? Would you prefer to see the Oversight Board or the RTC given more discretion in establishing ethical standards for its employees and contractors, in light of the unusual nature of its mission?

A.4. The Oversight Board and the RTC adopted a final common rule setting forth the Qualification of, Ethical Standards of Conduct for, and Restrictions on the Use of Confidential Information by Independent Contractors. This rule, which was adopted February 5, 1990, incorporates the statutory bars contained in FIRREA, adds a provision regarding persons currently in default to any federal deposit insurance funds, and enumerates a list of discretionary qualifications.

As your letter states, certain persons are barred completely from working for, or contracting with, the RTC due to past activities, while others are barred because of their business relationships. The final regulation is, we believe, responsive to the concerns expressed by the many people who took the time to comment upon the proposed regulations. For instance, the scope of the final rule narrows applicability to contracts for professional services, allows the agency to contract outside of these provisions for small contracts (those not anticipated to aggregate more than $25,000 per office operations or conservatorship per year), and excludes day-to-day maintenance and operations contracts. The final rule also allows (1) waiver of the discretionary qualifications, (2) emergency contracting situations, and (3) provides that procedures will be adopted to allow review of any denial of eligibility to contract with the RTC. In addition, the provisions regarding concurrent and subsequent participation issues now provide for waivers contingent upon proper screening procedures or competitive bid situations.

The final rules have not deterred some 12,000 persons or firms wishing to do business with the RTC from requesting registration packets. To date, over 600 firms have been qualified to be independent contractors to the RTC with the number increasing daily. Be assured that we are fully cognizant of the potential burden these rules may impose upon the RTC's independent contracting activities but are firm in our resolve that those who were instrumental in creating the problem, which the RTC was chartered to resolve, not benefit from its resolution.

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